# DISTINGUISHING THE ARBITRABILITY OF TAX DISPUTES FROM CONTRACTUAL DISPUTES ARISING FROM TAX-RELATED OBLIGATIONS UNDER NIGERIAN LAW[*]

**Abstract**
*For a considerable period, there is uncertainty regarding the distinction between the arbitrability of tax disputes and disputes arising out of contracts apportioning tax obligations under Nigerian law. This article addresses the extant position of Nigerian law regarding the subject. It assesses the restrictions and interference imposed under Nigerian law when a contractual dispute submitted to arbitration has an element of taxation, however minimal, with particularly reference to developments in case law involving production sharing contracts entered into by the Nigerian National Petroleum Corporation (NNPC)[1] and multinational oil companies.*

**Keywords:** arbitration, arbitrability, contracts, disputes, Nigeria, production sharing contracts, tax.

## 1. Introduction

The concepts of contractual liberty and party autonomy are the bedrock of arbitration. Generally, parties to an arbitration agreement enjoy the freedom to determine the mechanisms for resolving disputes arising from their contract. However, this autonomy is not absolute and may be subject to limitations that could curtail the types of disputes that can be settled through arbitration. Primarily, these restrictions flow from or are dependent on the subject matter of the dispute. One such area is taxation. Under Nigerian law, tax disputes are not arbitrable due to the peculiar and sensitive nature of fiscal matters which directly or indirectly affect the country's wealth generation. Such fiscal matters are believed to be best suited for the courts. While this article does not seek to dabble into the jurisprudential debate on whether the current Nigerian law position regarding the arbitrability of tax disputes should remain or be jettisoned, it highlights the importance of distinguishing between tax disputes and disputes arising from a contract regarding tax-related obligations. This distinction is particularly important as it relates to Production Sharing Contracts (PSCs) and other related contracts in the oil industry, from which disputes that appear tax-related often arise. To achieve this, there is a need to clearly distinguish between tax disputes which cannot be subjected to an arbitral tribunal and contractual disputes that involve tax-related obligations, but do not have any impact on the statutory powers of tax authorities, jurisdiction of the courts, and the revenue of the government.

## 2. Arbitrability of Disputes under Nigerian Law

Arbitration is a dispute resolution mechanism that arises from the agreement of parties to resolve their disputes in a private, confidential, and binding manner. In essence, such disputes are resolved by an individual or panel acting in a private capacity, rather than through courts of law. The concept of arbitrability of a dispute pertains to whether a particular type of dispute can be resolved by the private arrangement of the parties or whether the disputes are by their nature reserved for the courts. The rationale behind this concept stems from the fact that certain matters are considered very important to public policy and the administration of justice, among others, warranting their exclusive adjudication by the courts. In that vein, arbitrability is a central theme that arbitrators, judges, and lawyers frequently deal with. Before a matter can be referred to arbitration under Nigerian law, same must first be arbitrable. The dispute must not relate to or cover matters which, by law, can only be settled by the courts.[2]

The primary law governing commercial arbitration in Nigeria is the Arbitration and Mediation Act (AMA) 2023 which aligns substantially with the United Nations Commission on International Trade Law (UNCITRAL) Model Law. Given that Nigeria is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention), it has domesticated the New York Convention in the AMA. A review of the AMA suggests that certain disputes cannot be submitted to arbitration. However, the AMA fails to provide further guidance regarding the kind of disputes that are non-arbitrable. It simply provides in Section 65 as follows: 'This Act shall not affect any other law by virtue of which certain disputes - (a) May not be submitted to arbitration; or (b) May be submitted to arbitration only in accordance with the provisions of that or another law. Further, Section 55(3) of the AMA outlines the grounds upon which a Nigerian court may set aside an arbitral award such as situations where the court determines that the subject matter of the dispute is not capable of settlement through arbitration; or that the award is against the public policy of Nigeria. These provisions are the closest that Nigerian statutes come to offering guidance on the arbitrability of disputes. In the absence of explicit statutory provisions delineating what disputes are arbitrable, attention inevitably turns to case law for clarity.

[*]**By Stanley U. NWEKE-EZE**, **LLB (First Class Honours) (NAU), LLM (Commercial Law) (Cambridge), LLM (International Law) (Harvard), PhD (International Investment Law) (Hong Kong).** Admitted to practice law in Nigeria, State of New York, and England and Wales. Email: snwekeeze@llm17.law.harvard.edu.

[1]Now Nigerian National Petroleum Company Limited in line with the Petroleum Industry Act, 2021

[2] Section 65 of the Arbitration and Mediation Act, 2023

In *Kano State Urban Development Board v Fanz Construction Ltd*,[3] the Supreme Court, whilst relying on Halsbury's Laws of England,[4] identified the following categories of matters as non-arbitrable in Nigeria: (*i*) indictment for an offence of a public nature; (*ii*) disputes arising out of an illegal contract; (*iii*) disputes arising out of void agreements, as being by way of gaming or wagering; (*iv*) disputes leading to a change of status as in a divorce; and (*v*) any agreement purporting to give an arbitrator the right to give judgment *in rem*.[5] Similarly, in *B.J. Exports & Chemical Processing Company Ltd v Kaduna Refining and Petrochemical Company Ltd*,[6] the Court of Appeal held *inter alia* that matters bordering on the allegation of the commission of the offence of fraud are simply not arbitrable under Nigerian law. In addition, the Supreme Court, in *UBA Plc v Triedent Consulting Ltd*,[7] held that notwithstanding the terms in any contractual agreement, a claim for defamation arising out of libel can only be determined by a Court of law. Hence, this effectively makes it clear that an arbitral tribunal cannot determine legal questions on defamation. Thus, for a comprehensive understanding of what disputes are arbitrable and non-arbitrable under Nigerian law, it is essential to consider both statutes and judicial precedents.

**3. Arbitrability of Tax Disputes under Nigerian law**

It is a settled position under Nigerian law that tax disputes are non-arbitrable.[8] The rationale for this somewhat generally accepted position regarding the arbitrability of tax disputes is rooted in the principle that matters of taxation fall within the exclusive competence of states. In other words, legislation and adjudication on taxation are considered direct exercises of sovereignty by states. Subjecting tax matters to the whims of private persons (including arbitral tribunals) may compromise the power and sovereignty of states and may amount to a relinquishment of control. Moreover, given that taxation is closely linked to government revenue and funding, it can be argued that entrusting the determination of such matters to tribunals would not be economically prudent.

This position of Nigerian law flows firmly from the decisions of the Court of Appeal in similar cases pertaining to PSCs – i.e., *Esso Petroleum and Production Nigeria Ltd & SNEPCO v NNPC* (*the Esso Case*)[9] and *Shell (Nig.) Exploration and Production Ltd & 3 Others v Federal Inland Revenue Service* (*the Shell Case*).[10] As discussed below, however, the Court of Appeal took a slightly different view in *Esso Petroleum and Production Nigeria Limited & Shell Nigeria Exploration and Production Company Limited v Federal Inland Revenue Service & Nigerian National Petroleum Corporation* (*the FIRS Case*).[11] These decisions (altogether, the *Esso, Shell and FIRS Cases*) are assessed below.

**The Esso Case**

In this case, Esso, as the contractor, instituted arbitration proceedings against NNPC for breaching the terms of the PSC between Esso and NNPC. By the PSC, Esso was to bear the full operational costs, prepare the Petroleum Profits Tax (PPT)[12] returns on behalf of all the parties to the PSC, and determine the lifting allocation of available crude oil. NNPC, on its part, was to file the PPT returns, as prepared by the contractor, with the Federal Inland Revenue Service (FIRS), and then subsequently lift the requisite amount of crude oil in accordance with the lifting allocation that had been prepared by the contractor. However, NNPC unilaterally lifted more crude oil than allocated and submitted unauthorized PPT returns to the FIRS contrary to the terms of the PSC. Consequently, Esso commenced arbitration proceedings in that regard, and subsequently obtained an award in its favour. NNPC, however, sought to set aside the award at the Federal High Court, arguing that the issue was a tax dispute and tax disputes are non-arbitrable under Nigerian law. Therefore, the award was handed without jurisdiction. The Federal High Court delivered judgment in favour of NNPC and set aside

[3] *Kano State Urban Development Board v Fanz Construction Ltd,* (1990) 4 NWLR (Pt. 142) 1 at page 33 paragraphs A – B

[4] Halsbury's Laws of England (4th Edn, 2006) Vol 38 page 256, para. 503

[5] The Supreme Court also held that disputes which parties seek to refer to arbitration must consist of a justiciable issue that is triable civilly. A fair test of this is whether the difference can be compromised lawfully by way of accord and satisfaction.

[6] *B.J. Exports & Chemical Processing Company Ltd v Kaduna Refining and Petrochemical Company Ltd,* (2002) LPELR -12175 (CA).

[7] *UBA Plc v Triedent Consulting Ltd,* (2023) LPELR-60643 (SC)

[8] *Esso Petroleum and Production Nigeria Ltd & SNEPCO v NNPC* (2016) 8 CLRN pg. 1.

[9] *Esso Petroleum and Production Nigeria Ltd & SNEPCO v NNPC* (2016) 8 CLRN pg. 1.

[10] *Shell (Nig.) Exploration and Production Ltd & 3 Others v Federal Inland Revenue Service* (2016) 11 CLRN pg. 36.

[11] *Esso Petroleum and Production Nigeria Limited & Shell Nigeria Exploration and Production Company Limited v Federal Inland Revenue Service & Nigerian National Petroleum Corporation* (2018) 2 CLRN pg.17

[12] The Petroleum Profit Tax Act, Cap P13 LFN 2004 ('PPTA'). Please note that the PPTA is undergoing a conditional repeal by section 310 of the Petroleum Industry Act (2021) ('PIA') which also expressly repeals a few other industry-specific Acts from its effective date. The condition precedent set by the PIA for the repeal of the PPTA, is provided under subsection (1)(g) which states that the repeal of the PPTA shall only be effective after the completion of the conversion process of oil prospecting licences ('OPL') to a petroleum prospecting licence ('PPL') or oil mining lease ('OML') to petroleum mining lease ('PML'); and the repeal shall also apply to any new acreage under the PIA. This means that from the PIA effective date, where an OPL or OML is converted to a PPL or PML, the repealing provision of the PIA on the PPTA takes effect. However, section 311 (9) of the PIA saves the PPTA until the termination or expiration of ALL OPLs and OMLs. In effect, this establishes a transitionary period for the PPTA to the replacement laws, the Companies Income Tax Act and the National Hydrocarbon Tax Act. Where there is a new acreage or a conversion, section 310 of the PIA (which repeals the PPTA) takes effect.

the award on that basis. Esso appealed to the Court of Appeal, arguing that the dispute between the parties was purely contractual and not tax related. NNPC, however, continued to maintain that the dispute was tax-related because it involves calculation of PPT returns pursuant to Nigerian tax laws. The Court of Appeal, in summary, held that since the dispute between the parties related to the eventual amount of PPT payable, the dispute was a tax dispute in the garb of a commercial dispute, and as such, the arbitral tribunal did not have the jurisdiction to handle same.[13]

**The Shell Case**

Shell and three other parties (i.e., the 2nd - 5th Appellants) and the 2nd Respondent (i.e., NNPC) entered into a PSC in respect of Deep Offshore Mining Lease 118 (OML 118 PSC), with the aim of exploration of oil in Nigeria's deep-water acreages. The PSC specified how crude oil finds would be allocated between the parties based on categories like 'royalty oil', 'cost oil', 'tax oil', and 'profit oil' as defined under the OML 118 PSC (i.e., *lifting allocation*). The parties agreed that the contractor—Shell—had the sole right and responsibility to compute the lifting allocation, including 'tax oil' and parties were enjoined to respect their various entitlements without exceeding same. The contractor alleged that NNPC breached the PSC by lifting more crude oil than it was entitled to lift. Consequently, the 2nd to 5th Appellants commenced arbitration proceedings against NNPC.

Upon becoming aware of the arbitration proceedings against NNPC, FIRS filed an originating summons at the Federal High Court challenging the arbitration proceedings. The FIRS argued that the matter could not be settled by the arbitral tribunal as it was a tax dispute, and such is not arbitrable by virtue of section 251 (1)(a) and (b) of the 1999 Constitution (as amended) which vests exclusive jurisdiction in matters of taxation of companies in the Federal High Court. The Federal High Court held that the claim indeed arose out of a tax matter and was not arbitrable. Dissatisfied, the contractor appealed to the Court of Appeal. At the Court of Appeal, the contractor's position was that since the FIRS was not a party to the arbitral proceedings, it lacked *locus* to challenge the proceedings before the arbitral tribunal. The Court of Appeal considered the appeal, examining whether the dispute was contractual or tax-related. The Court of Appeal held that tax matters, including the payment of PPT are statutory and not contractual. The Court of Appeal further held that FIRS has exclusive authority to administer tax legislation and enforce tax payments. The court concluded that the issues before the arbitral tribunal were tax matters, as they involved allegations of NNPC breaching the PSC by improperly lifting tax oil. Therefore, the Court of Appeal ruled that the arbitral tribunal lacked jurisdiction to hear the dispute.

**The FIRS Case**

This case is an offshoot of the *Esso Case* above. On becoming aware of the arbitral proceedings commenced by Esso against NNPC, the FIRS filed an action at the Federal High Court, challenging the jurisdiction of the arbitral tribunal to hear the matter on the grounds that it was purely a tax matter, therefore outside the tribunal's jurisdiction. Esso, on the other hand, submitted that the claim was a purely contractual matter, specifically concerning how oil produced from the contract area would be split between Esso and NNPC as agreed under the PSC. The Federal High Court concluded that the dispute among the parties was contractual as the major substance of the complaint was that NNPC violated the contractual provisions for the preparation of the PPT returns. The Federal High Court opined that the mere fact that parties are guided by tax legislation in determining lifting allocation of tax oil or filing PPT returns does not mean that the contractual dispute—which was basically hinged on breach of an obligation not to lift in excess of the assigned allocation of crude oil, and the right to prepare PPT returns—was a tax dispute. The Federal High Court, however, held that, while the case of Esso at the arbitral tribunal was essentially contractual, the monetary relief sought by Esso is in effect a tax refund and, as such, a tax matter which was beyond the competence of the tribunal.

**4. Drawing a parallel line between contractual disputes arising out of tax obligations and tax disputes under Nigerian law**

While the decisions in the *Esso, Shell and FIRS Cases* set a precedent for determining whether a tax-related dispute may be subject to arbitration, there is only a faint line drawn between tax disputes and contractual disputes arising out of tax-related obligations by the courts. The decisions of the Court of Appeal in the *Esso and Shell Cases* give rise to an important legal question as to when a dispute between parties can be regarded as a tax dispute or a contractual dispute. While it seems settled that a tax dispute is not arbitrable, it is not clear what a tax dispute really is. It is indeed imperative that some form of distinction be provided between what constitutes a tax dispute (and the requisite avenue to resolve same) and a contractual dispute. The FIRS Act[14] defines 'tax' as follows: '… 'tax' includes any duty, levy or revenue accruable to the Government in full or in part under this Act, the laws listed in the First Schedule to this Act or any other enactment of law.' If a tax dispute arises (for instance, regarding the quantum of tax payable by a company to the tax

[13] Also, the Court of Appeal held that the aspect of the dispute which pertains to the calculation of the PPT returns and calculation of lifting allocations was severable from the tax dispute. Thus, even though it affirmed the decision of the High Court that tax disputes are non-arbitrable, it ordered a restoration of the final award of the arbitral tribunal with respect to the calculation of PPT returns and calculation of lifting allocations.

[14] Federal Inland Revenue Service (Establishment) Act 2007 (No. 13).

authority), a statutory procedure is laid out regarding how such a company or individual can dispute the tax amount.[15] Currently, the position is that a party aggrieved by a tax assessment or demand notice is required to file an objection to the FIRS (or the relevant tax authority) for a review of the assessment. If the result of the review is not satisfactory, such a party may appeal the decision to the Tax Appeal Tribunal, if appropriate, and may further appeal against the decision of the Tax Appeal Tribunal (on points of law) to the Federal High Court. Where the taxpayer is not satisfied with the decision of the Federal High Court, it may appeal to the Court of Appeal and, where the party is still not satisfied, to the Supreme Court.[16]

Flowing from the foregoing, a dispute centred on the calculation of PPT returns is a tax dispute and, based on the interpretation given to same by the Court of Appeal in the *Shell and Esso Cases*, should be non-arbitrable. However, what is contemplated by the above statutory procedure is a dispute between a tax authority and a taxpayer where the taxpayer is aggrieved by a tax assessment made by the tax authority. Indeed, it is not all cases involving tax elements that would constitute a tax dispute, and thus, render same non-arbitrable under Nigerian law. Put differently, the mere fact that the dispute between the parties touches on certain tax obligations does not mean that it is a tax dispute, and therefore, inarbitrable. Instead, it is important to assess the specific rights and obligations of the parties under the contract. Disputes that centre around the interpretation of contractual terms or the performance of contractual obligations by the parties to a contract do not acquire the character of tax disputes by the mere fact that they may touch on taxation provisions of a statute. Such disputes do not automatically become arbitrable and fall within the exclusive purview of the courts.

The importance of distinguishing between tax disputes and contractual disputes arising out of tax-related obligations is further strengthened when one considers the peculiarity of contracts such as PSCs in the Nigerian market. Indeed, a PSC would typically contain clauses which somewhat impact tax issues and contain an arbitration clause. For example, PSCs usually contain a clause which provides that the tax returns to be filed in relation to the relevant OML shall be prepared by the contractor and NNPC has a duty to file the tax returns as prepared by the contractor. In addition, PSCs often contain an important clause which gives the contractor the exclusive right to prepare the parties' lifting allocation which includes the quantity of oil to be lifted by NNPC for payment of tax for the contract area, known as 'tax oil'. And NNPC is contractually bound to abide by these provisions. These provisions are, in fact, enforceable contractual terms, though they may have a bearing on the tax payable for the relevant contract area. What happens when NNPC lifts more 'tax oil' than it is contractually entitled to or files a different tax return with a different filing position from the returns prepared by the contractor in breach of the PSC? It would raise a very serious challenge if, relying on the *Shell Case* or *Esso Case*, we take the position that PSC contractors are barred from referring such to arbitration by the mere fact that they share some affinity with tax issues.

Indeed, the Court of Appeal highlighted this point in the *FIRS Case* when it held that the mere fact that the PSC contractors in that case had relied on a tax legislation in determining the requisite PPT returns and lifting allocation did not render it a tax dispute, as it was a breach of these terms of the contract by NNPC that formed the basis of the dispute submitted to arbitration. This decision seems more accurate, even though it was a clear departure from the position held in the earlier cases, where the Court of Appeal held that the dispute before the arbitration tribunal was a tax dispute in the garb of a commercial dispute. Nonetheless, the Court of Appeal came to the conclusion that the FIRS, as the tax regulator, has the power to determine the right party who is entitled to and the extent of a tax refund[17] and, as such, the relief seeking an award of damages and interest for the value of over-lifted crude oil by NNPC will be tantamount to the PSC contractors requiring the NNPC to refund part of the over-lifted tax oil that was utilized in making the PPT payments to the FIRS. Accordingly, the Court of Appeal overruled the decision of the lower court which had nullified the entirety of the award, but upheld same with respect to the claims that it considered to be tax matters. [18]

In essence, even though the decision in the *FIRS Case* is an appreciable progress in the much-desired clarification regarding the arbitrability of tax disputes *vis-à-vis* contractual disputes, compared to the *Esso* and *Shell Cases*, the need to draw a parallel line between tax and contractual disputes still exists. The *FIRS Case* only partly upheld the contractor's claims. It appears therefore that where PSCs are concerned, even where the dispute originates from a contract, taxation cannot be entirely divorced from it. Taking it a step further, to distinguish between contractual and tax disputes in arbitration, it is recommended that we consider what amounts to a direct or indirect exercise of sovereignty. As earlier stated, taxation is an exercise of sovereignty by a state. It has been noted that matters which involve a direct exercise of

[15] This article does not consider the legality or otherwise of the statutory measures that such party is meant to exhaust before approaching the Federal High Court, especially in light of the constitutional provisions in that regard. In essence, whether the recourse to the Tax Appeal Tribunal is legal, when the Federal High Court is saddled with exclusive jurisdiction by the Constitution.

[16] For instance, see sections 38, 41 and 42 of the Petroleum Profit Tax Act, Cap P13 LFN 2004 repealed by the Petroleum Industry Act 2021 (Act No. 6) and has been replaced by the Companies Income Tax and the National Hydrocarbon Tax.

[17] Section 23 of the Federal Inland Revenue Service (Establishment) 2007 (No. 13).

[18] See generally Ibifubara Berenibara and Chizaram Uzodinma, Nigeria: Case Review: Esso Petroleum And Production Nigeria Limited & SNEPCO v. FIRS & NNPC (2018) https://www.mondaq.com/Nigeria/Energy-and-Natural-Resources/707220/Case-Review-Esso-Petroleum-And-Production-Nigeria-Limited-SNEPCO-v-FIRS-NNPC (accessed 16 April 2024)

a sovereign authority (for instance, the FIRS, in a Nigerian context) should not be arbitrable. Conversely, those that only involve an indirect exercise of the effect of sovereign authority should be arbitrable.[19] For context, a provision in a PSC stating that hydrocarbon tax and tax payable on income is capped at a certain rate raises substantive tax law questions on what constitutes 'income' or 'hydrocarbon tax'. The determination of this question involves a direct exercise of sovereign authority, and such a question cannot be subject to arbitration. However, if there is already an agreement between the parties on what constitutes 'income' and 'hydrocarbon tax', then any disputes arising from this provision of the PSC should be guided by the agreement of the parties. Indeed, the direct exercise of sovereign authority would not arise, and such a matter may be subject to arbitration.

Another example to consider is a provision in a contract stating that a contractor shall abide by the tax law of the state. In this case, a tax dispute would be inarbitrable because any dispute arising in connection with such a provision would demand substantive determination of the taxation law of the state, that a contractor had already agreed to abide by, and this is considered to be a direct exercise of sovereignty. In contrast, if a provision in a mutually agreed contract grants some tax exemptions to a contractor, then a dispute arising out of failure to comply with same will be arbitrable. This distinction is, however, not always crystal clear and usually involves a deep analysis of the dispute to determine whether there may be a direct or indirect exercise of sovereign authority. An example of such a complex scenario may emanate when stabilization clauses are considered. Prior to the enactment of the PIA, stabilization provisions were exclusively within the purview of states. However, with the enactment of the PIA, pioneer provisions on stabilization have been included. Notably, section 305 of the PIA abrogates stabilization clauses as they pertain to generally applicable taxes – for example, tertiary education tax, value added tax, as well as levies, taxes, or payments in respect of environment, labour, health, and safety; and new taxes, levies, or duties to implement Nigeria's commitments with respect to climate change under the United Nations Framework Convention on Climate Change. Where matters arise in relation to stabilization provisions that deal with the taxes listed in section 305 of the PIA, it is arguable that the determination of such a dispute would be within the exclusive competence of a state. Such a matter may involve the exercise of sovereign authority to determine the questions raised. However, since stabilization clauses are generally based on agreement between the parties, then it is also arguable that such a matter can be subject to arbitration. It is thus important to critically analyse every case/situation and determine whether there has been a direct exercise of sovereign authority in order to distinguish between contractual and tax disputes, as appropriate.

**5. Conclusion**

While arbitration embodies the principles of contractual liberty and party autonomy, its scope is limited by the relevant subject matter. Tax disputes, given their inherent connection to the fiscal sovereignty of a state, cannot be settled by arbitration under Nigerian law. This article has clarified the arbitrability of tax disputes, including the difference between contractual disputes relating to tax obligations and tax disputes by considering the nature of the exercise of sovereign authority. It is, however, important for the legislature to take steps towards clarifying the difference between both classes of disputes in relevant tax statutes to prevent ambiguity. Indeed, such legislative clarity will not only enhance the effectiveness of arbitration as a dispute resolution mechanism, but also promote confidence in Nigeria as an arbitration-friendly jurisdiction.

[19]Mazin Ezzledin, *Arbitrability of Tax Disputes in Commercial and Investment Arbitration* (Saarland University, Saarbrucken 2021).