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## Client Alert

## An Overview of the Upstream Petroleum Operations (Cost Efficiency Incentives) Order, 2025

### Introduction

On 30 May 2025, the President of the Federal Republic of Nigeria issued the *Upstream Petroleum Operations (Cost Efficiency Incentives) Order, 2025* (the “**Order**”) which established a cost efficiency incentive framework (the “**Incentive**”). The Order was issued pursuant to the President's powers under the Companies Income Tax Act to exempt the profits of any company from tax, or to remit the taxes of any company.<sup>1</sup>

As can be gleaned from its recital, the Order is stated to have been issued in view of the fact that operating costs in the Nigerian oil and gas sector have been observed to be high compared to global average, arising mainly from prolonged project execution timelines and local content requirements. In light of the foregoing state of affairs, the Order introduces the Incentive, with a view to improving efficiency and enhancing Nigeria's competitiveness in the global oil and gas sector. By the introduction of the Incentive, the Order aims to reduce operating costs through cost reduction measures and promote cost discipline among stakeholders in the upstream petroleum industry

<sup>1</sup> Sections 23 (2) and 89 of the Companies Income Tax Act, Cap C21, Laws of the Federation of Nigeria, 2004

Although the Order was issued on 15 May 2025, the Incentive is expected to take effect from 30 April 2025<sup>2</sup> and shall cease to have effect on 31 May 2035, unless extended or otherwise modified by the President. Furthermore, any Incentive unused by a lessee or licensee as of the cessation date shall become invalid and unenforceable.<sup>3</sup>

## Highlights of Key Provisions of the Order

### 1. Scope of Application and Eligibility Criteria

The Order outlines the categories of persons eligible for the Incentive as well as the conditions that must be met for the incentive to be granted. Specifically, it applies to lessees, licensees, and their contractors<sup>4</sup> operating in the upstream petroleum sector.<sup>5</sup>

In the Order, Lessees, Licensees and the Contractors are given the meanings ascribed to such terms under the Petroleum Industry Act (PIA), thereby raising concerns as to whether the incentive is restricted to converted entities under the PIA. While the definition of a Lessee under the PIA appears to be tilted towards converted leases (i.e., holders of Petroleum Mining Leases), the definitions for Licenses and Contractors encompass both converted and unconverted entities.

While it may be argued that the reference to lessees, licensees and the contractors as defined under the PIA restricts the application of the incentive to converted assets under the PIA, it is unlikely that the intention of the Federal Government is for the Order to apply only to converted entities. From our viewpoint, considering that the Order was issued with the objective of reducing operating cost and maximising Nigeria's economic gains from upstream petroleum operations it is reasonable to conclude that the aim is for the Order to apply generally to all licensees, contractors and lessees operating in the upstream sector (without particular focus on converted or unconverted operators). Furthermore, the Order does not expressly restrict its application to converted entities.

Notably, the Incentive is only available to lessees, licensees, and contractors that achieve or surpass the cost reduction targets set by the Nigerian Upstream Petroleum Regulatory Commission (the "**Commission**").<sup>6</sup> This provision introduces a clear performance-based criterion, such that eligibility for the Incentives will be contingent upon meeting or exceeding the benchmarks established by the Commission, annually.<sup>7</sup> In essence, the Order establishes a system where only entities in the sector demonstrating measurable cost efficiency and operational discipline are rewarded with the Incentives.

### 2. Administration of the Incentive

The Order confers the administration of the Incentive on the Commission, and vests the Commission with the following obligations:

<sup>2</sup> Paragraph 8 of the Order

<sup>3</sup> Paragraph 4(3) of the Order

<sup>4</sup> Contractor means a contractor in a profit-sharing contract or production sharing contract as contemplated in the Petroleum Industry Act, No. 6, 2021 and any other petroleum law in force.

<sup>5</sup> Paragraph 2 (1) of the Order

<sup>6</sup> Paragraph 2(2) of the Orders

<sup>7</sup> Paragraph 3 of the Order

- Assessment studies and benchmarking: The Commission shall conduct comprehensive assessments and benchmarking studies to establish appropriate cost benchmarks for upstream operational activities and Unit Operating Costs<sup>8</sup> across onshore, shallow water, and deep offshore terrains.<sup>9</sup> These benchmarks shall be determined in accordance with guidelines to be issued by the Commission pursuant to the Petroleum Industry Act (PIA), after consultations with relevant stakeholders. The underlying methodology used to determine the benchmarks must be published to ensure transparency.<sup>10</sup>
- Assignment of cost reduction target: The Commission is required to annually assign specific Unit Operating Cost reduction targets for the onshore, shallow water, and deep offshore terrains, factoring in the specificity of their operating environment and production volume.<sup>11</sup> In setting these cost targets, the Commission is to align Nigeria's upstream petroleum sector costs with global best practices, by aiming to eliminate cost premium and establish targets that drive year-on-year efficiency improvements.<sup>12</sup>
- Annual performance review to determine achievement of cost reduction: The Commission will conduct annual reviews of the lessee's or licensee's performance within their tax return cycle, with a key focus on assessing Unit Operating Costs to determine compliance with the established targets.<sup>13</sup> To ensure accuracy and integrity in this process, the Order requires the Commission to verify production numbers during the annual review;<sup>14</sup> and reconcile production and lifting volumes to avoid discrepancies from under-lift or over-lift scenarios.<sup>15</sup>

Lessees and licensees who achieve or surpass the prescribed cost performance and operating cost reduction targets in any given year will qualify for the Incentive.<sup>16</sup> The Commission is thereafter required to compile and forward the list of eligible companies for the Incentives to the Federal Inland Revenue Service (the "**Service**") for information, while also providing a copy to the Minister. This process must precede the formal claims by lessees or licensees for the incentives.<sup>17</sup>

### 3. Tax Credit Incentive

The Incentive is in the form of a tax credit and is to be claimable by eligible lessees or licensees in the financial year in which their actual operating costs are below the target cost set by the Commission.

The tax credit (which represents a proportion of the incremental government share derived from the reduced costs relative to the established targets)<sup>18</sup> is applied/offset against the overall tax liability of the lessee's or licensee's relevant asset. The tax credit is calculated in line with the below formula:<sup>19</sup>

<sup>8</sup> Unit Operating Cost means the cost incurred for the day-to-day functioning of upstream petroleum operations expressed on a per unit basis, excluding capital expenditures related to the development of new fields or large infrastructure investments

<sup>9</sup> Paragraph 3(1)(a) of the Order

<sup>10</sup> Paragraph 3(1)(b) of the Order

<sup>11</sup> Paragraph 3(1)(c) of the Order

<sup>12</sup> Section 6 (1) of the Order.

<sup>13</sup> Paragraph 3(1)(d) of the Order

<sup>14</sup> Paragraph 3(2)(a) of the Order

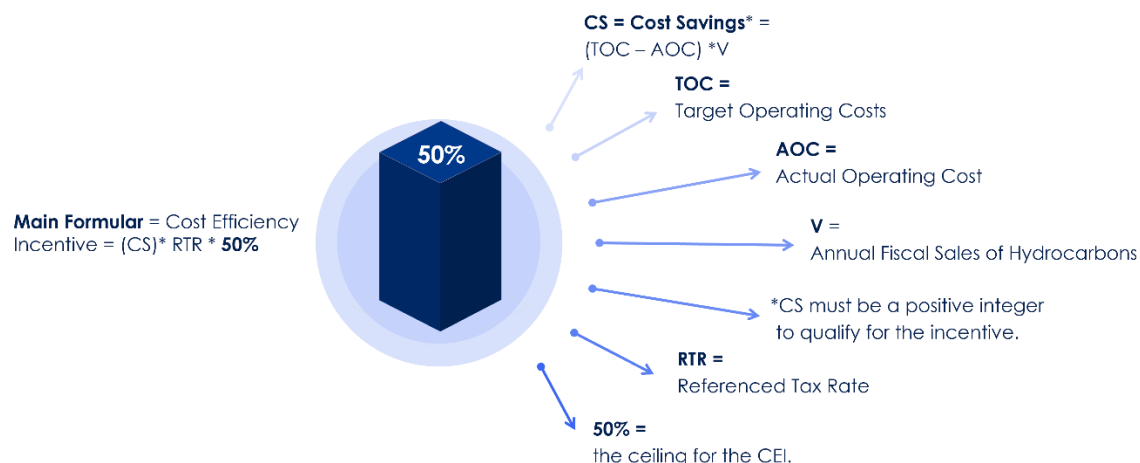
<sup>15</sup> Paragraph 3(2)(b) of the Order

<sup>16</sup> Paragraph 3(3) of the Order

<sup>17</sup> Paragraph 3(4) of the Order

<sup>18</sup> Paragraph 4(1) of the Order

<sup>19</sup> Paragraph 5(1)(2) of the Order



- **Actual Operating Costs** means the actual unit cost of operations expended by lessee and licensee, which shall be compared with the Target Operating Cost to determine eligibility for the CEI.
- **Target Operating Cost** means the target unit operating cost set by the Commission in furtherance of this Order.
- **Annual Fiscal Sales** of Hydrocarbons means the total volume of hydrocarbons measured at the relevant fiscal points used to determine payment of royalties in respect of the relevant asset where a CEI is to be claimed.

Thus, companies will receive tax credits for realised savings directly linked to their operating costs and production volume.

#### 4. Limitation on the Tax Credit Claimable

The tax credit granted under the Order is to be utilised to offset applicable income tax liability in the year the taxpayer meets or exceeds the Commission's benchmark; and must be utilised within three years of its issuance.<sup>20</sup> Also, the tax credit claimable in any year by lessees or licensees is capped at 20% of their annual tax liability.<sup>21</sup>

The implication of this is that where the tax credit granted to a lessee or licensee is in a year exceeds 20% of its tax liability, the lessee or licensee will be restricted to utilise the portion of the tax credit not exceeding 20% in a year while the unutilised portion will be carried forward to the subsequent year and subjected to the same restriction. Any tax credit not utilised within a period of three (3) year from its issuance will be forfeited.

It is important to note that the Order empowers the Service to validate all claims by ensuring the operating costs used to determine the cost efficiency incentive align with the costs used in computing an entity's adjusted profits for tax purposes.<sup>22</sup> Furthermore, lessees and licensees are required to ensure their cost reduction strategies do not involve harmful practices as may be determined by the Commission from time to time. Similarly, the Commission is vested with the power to reject any cost savings or reduction resulting from unfair or unethical dealings with contractors, employees, host communities or any other person.<sup>23</sup>

<sup>20</sup> Paragraph 6 (5) of the Order

<sup>21</sup> Paragraph 6 (2) of the Order.

<sup>22</sup> Paragraph 6 (3) of the Order

<sup>23</sup> Paragraph 6 (4) of the Order

## 5. Implementation Guidelines

The Order provides that the Service, in collaboration with the Commission, will issue implementation guidelines specifying information and data which a lessee and licensee shall submit to the Commission for the annual cost efficiency evaluation process as well as the details of the taxpayer's computation of the incentives.

The implementation guideline(s) will also require the Commission to publish, at the end of each annual cost efficiency evaluation, a list of companies that qualify for the tax incentives for that year on its website, prior to the deadline for filing tax returns for the relevant year.<sup>24</sup>

## Conclusion

From our review, the Order as well as the Incentive created thereunder are indeed laudable. If purposively and properly implemented, it is envisaged that the scheme will help create a cost efficiency framework in Nigeria's oil and gas sector, bolster investment creation in the sector and enhance Nigeria's competitiveness in the global oil and gas sector.<sup>25</sup>

<sup>24</sup> Paragraph 7 of the Order

<sup>25</sup> That said, there may be concerns as to the future validity of the Order, in view of the imminent passage of Nigeria Tax Bill (the "Bill"), which appears not to expressly codify the provisions of the Order. This concern is further underscored by the fact that the (current draft of the) Bill expressly revokes the Oil and Gas Companies (Tax Incentives, Exemption, Remission, etc.) Order 2024, while deliberately codifying only one of the two incentives previously granted under it. It may be important for the Federal Government to consider allaying possible concerns as to the future validity of the Order