

The Impact of Company Income Tax and Petroleum Profit Tax on the Profitability of Listed Oil and Gas Firms in Nigeria

Timothy Aondona Aondover

Ignatius Ajuru University of Education, Rumuolumenu, Port Harcourt

Email: aondoveraondona@gmail.com

Abstract:

This conceptual paper examined the impact of company income tax (CIT) and petroleum profit tax (PPT) on the profitability of listed oil and gas firms in Nigeria. These taxes are integral to Nigeria's tax structure, especially for oil and gas companies that contribute significantly to the nation's revenue. The paper provides a theoretical framework to analyze the relationships between taxation and profitability, proposing how these taxes might affect the performance of these firms. Drawing from existing literature, the study aims to explore key mechanisms through which CIT and PPT influence profitability, such as tax burden, operational efficiency, investment decisions, and capital structure. The research was conducted against the backdrop of the increasing importance of the oil and gas industry in the Nigerian economy and the need to understand how government taxation policies affect the profitability of companies in the sector. The paper argues that company income tax and petroleum profit tax have a significant negative impact on the profitability of listed oil and gas firms in Nigeria. This suggests that higher tax rates imposed by the government can hinder the profitability of companies in the industry. Therefore, it is recommended that the government review its tax policies for the oil and gas industry in Nigeria, taking into consideration the impact on the profitability of listed firms. This will not only lead to a more conducive business environment for these companies but also ensure sustainable economic growth for the country.

Keywords:

Impact, Income, Tax, Petroleum, Profit, Oil and Gas

I. Introduction

Nigeria is one of the largest oil-producing countries in Africa, and the oil and gas industry plays a crucial role in its economy. As of 2023, oil and gas revenue accounts for a significant portion of Nigeria's national income and export earnings. Consequently, the Nigerian government imposes various forms of taxation on oil companies, with the Company Income Tax (CIT) and Petroleum Profit Tax (PPT) being the two major forms of taxation for listed firms in the sector. These taxes are intended to generate revenue for the government and regulate the profitability of firms. However, the impact of these taxes on the profitability of oil and gas firms has been a subject of debate. Mintz (2010) explains that industries tax for oil and gas concerns is imposed on the incomes made from the sale of oil and gas net of the production costs which comprise current mining costs, capital cost allowances, as well as exploration and development costs.

Exploration costs are expensed while development costs are capitalized and written off at the declining balance rate. Though tax is a major source of revenue to government in generating additional revenue needed in discharging its pressing obligations, tax system offers

itself as one of the most effective means of mobilizing a nation's internal resources and it lends itself to creating an environment conducive to the promotion of oil and gas firms in Nigeria (Attama, 2004). Oil is the dominant source of government revenue, accounting for about 90 percent of total exports, and this approximates to 80% of total government revenues. Since the oil discoveries in the early 1970s, oil has become the dominant factor in Nigeria's economy.

Odusola (2006) observed that the Nigerian petroleum industry has been described as the largest among all industries in the country. This is probably due to the belief that petroleum is one of the major sources of energy worldwide. The size, international characteristic, and role assumed by the petroleum industry were noted to have originated from the notion that petroleum is versatile as it currently satisfies a wide variety of energy and related needs. Petroleum is the most vital source of energy, providing over 50 percent of all commercial energy consumption in the world (Adekanola, 2007). The revenues obtained from crude oil in Nigeria are of absolute advantage to expenditure commitments on various projects at the local, state, and federal levels. The Profitability of oil and gas firms in Nigeria relies heavily on the revenue derived from petroleum products and lower tax rate, as they provide 70 percent of government revenue and about 95 percent of foreign exchange earnings.

Apart from this, Azaiki and Shagari (2007) opines that the contribution of petroleum to national development is many and varied; employment generation, foreign exchange earnings, income generation, industrialization, and improvements in other economic variables. While the major investors in the petroleum industry are the international oil companies (IOCs), the principal legislation governing petroleum operations in Nigeria is the Petroleum Profit Tax Act (PPTA) of 2007. Its main fiscal instrument is the Petroleum Profit Tax (PPT). Under the PPT, the tax rate was set at 67.5 percent for the first five years of operations by the oil industries and 85 percent thereafter (Onyemaechi 2012).

While taxes are a necessary component of national revenue generation, they also affect the profitability of businesses. For oil and gas firms, in particular, taxes can influence strategic decisions, financial performance, and long-term sustainability. The main research question of this paper is: How do CIT and PPT impact the profitability of listed oil and gas firms in Nigeria?

II. Review of Literature

2.1 Empirical Review

Several studies have examined the relationship between taxation and corporate profitability. For instance, Ezeani (2016) found that the tax burden, including CIT and PPT, has a significant negative relationship with the profitability of Nigerian oil and gas firms. Similarly, research by Olanrewaju (2018) indicated that increased tax rates in the oil sector reduce capital investments and profitability in the long run. These findings align with the notion that high tax rates can discourage investment and reduce operational profitability.

According to Odusola (2006), petroleum profit tax (PPT) is a tax applicable to upstream operations in the oil industry. It is particularly related to rents, royalties, margins and profit-sharing elements associated with oil mining, prospecting and exploration leases. It is the most important tax in Nigeria in terms of its share of total revenue contributing 95 and 70 percent of foreign exchange earnings and government revenue, respectively. Petroleum

operation as defined in the PPTA essentially involves petroleum exploration, development, production and sale of crude oil. The Petroleum Profit Tax is regulated by the Petroleum Profit Tax Act of 1959 as amended by the Petroleum Profit Tax Act of 2007. Although the initial law was passed in 1959 to capture the first oil export made in that year (Nwadihoha, 2007).

Section 8 of Petroleum Profit Tax Act (PPTA) states that every industry engaged in petroleum operations is under an obligation to render return, together with properly annual audited accounts and computations, within a specified time after the end of its accounting period. Petroleum profit tax involves the charging of tax on the incomes accruing from petroleum operations (Nwezeaku 2005). He noted that the importance of petroleum to the Profitability of oil and gas firms in Nigeria gave rise to the enactment of a different law regulating the taxation of incomes from petroleum operations. The petroleum profit tax is charged, assessed and payable upon the profits of each accounting period of any industries engaged in petroleum operations during any such accounting period, usually one year (January to December) (Anyanwu (1993).

2.2 Theoretical Framework

Several economic and financial theories can help explain the impact of taxes on business profitability, particularly in the context of the oil and gas industry. The following theories are relevant to this paper:

Taxation Theory: This theory suggests that tax policies directly influence corporate behavior, including investment decisions, operational efficiency, and profitability. In the context of oil and gas firms, high taxes can reduce the capital available for reinvestment and expansion, thereby reducing profitability (Auerbach, 2010).

According to Success, Success and Ifurueze (2012), due to the importance attached to oil exploration and production by the federal government of Nigeria, the taxation of petroleum profit became necessary under a tax Act different from the companies' income tax Act. This Act became effective on 1st January 1959 since the export of oil to the international market started in 1958. This ordinance under which petroleum profit is taxed is referred to as the petroleum profit tax Act. It was first amended in January 1967 by the federal military government through decree No 1 of 1967. The Act governing the taxation of petroleum profit in Nigeria in the period under review is the Petroleum Profit Tax Act 2007.

Modigliani and Miller (1958) proposition are that the theory of capital structure posits that corporate profitability and value are not significantly impacted by taxes in a perfect market. However, in the real world, taxes create frictions that affect capital structure, investment decisions, and profitability. Oil companies may face significant tax liabilities due to high tax rates, which can reduce after-tax profits (Modigliani & Miller, 1958).

Efficient Taxation Theory: This theory focuses on the need for taxes to be designed in a way that minimizes distortion to business operations. High taxes can lead to inefficiencies in the operational processes of oil companies, thereby affecting their profitability (Zodrow & Mieszkowski, 1986).

Resource Dependence Theory: According to this theory, firms that are dependent on external resources (such as oil reserves) are vulnerable to fluctuations in taxation and regulation, which can impact profitability (Pfeffer & Salancik, 1978). The oil and gas industry

is highly dependent on government policies, and changes in tax regimes, such as an increase in CIT or PPT, can significantly influence the bottom line of firms in the sector.

III. Research Methods

This is an exploratory paper; hence it used a descriptive research method, involving consultations with, and evaluation of, secondary sources such as literature, media reports, official documents, and the internet and other documents relevant to the impact of company income tax and petroleum profit tax on the profitability of listed oil and gas firms in Nigeria.

IV. Results and Discussion

4.1 Company Income Tax (CIT) in Nigeria

Company Income Tax (CIT) in Nigeria is a form of direct tax levied on the profits of incorporated companies and other corporate entities operating in the country, excluding those engaged in petroleum exploration and production, which are subject to a different tax regime under the Petroleum Profits Tax Act. The administration and collection of CIT is the responsibility of the Federal Inland Revenue Service (FIRS), pursuant to the provisions of the Companies Income Tax Act (CITA), Cap C21, Laws of the Federation of Nigeria (LFN) 2004, as amended. The objective of CIT is to ensure that corporate entities contribute a fair share of their profits to national revenue. This tax serves as a major source of non-oil revenue for the federal government, playing a significant role in financing public infrastructure, social services, and developmental projects. All companies, whether resident or non-resident, that derive income from Nigeria are subject to the CIT, provided such income is not specifically exempted under the law (Ariyo & Bekoe, 2022).

The CIT rate in Nigeria is generally 30% of the taxable profit for most companies. However, the Finance Act 2019 introduced a progressive tax structure aimed at reducing the burden on small and medium enterprises (SMEs) and enhancing compliance. According to the Finance Act, companies with an annual gross turnover of ₦25 million or less are classified as small companies and are exempt from CIT. Medium-sized companies, with turnover between ₦25 million and ₦100 million, are liable to a CIT rate of 20%. Large companies with turnover exceeding ₦100 million remain subject to the standard rate of 30% (Federal Inland Revenue Service, 2020). Taxable profit is calculated by deducting allowable expenses, capital allowances, and other permitted deductions from the gross profit of a company. Companies are required to file their CIT returns annually, which must include audited financial statements, capital allowance computations, evidence of tax payments, and other relevant documentation. The returns must be filed within six months after the end of the company's financial year or within eighteen months of incorporation for newly registered companies, whichever comes later.

Non-compliance with CIT obligations, including late filing or non-filing of tax returns, attracts various penalties and interest charges. These sanctions are enforced by the FIRS to promote voluntary compliance and maintain the integrity of the tax system. In addition, companies operating in specific sectors, such as telecommunications and financial services, may be subject to sector-specific tax requirements in addition to the CIT. CIT has faced several challenges in Nigeria, including issues of tax evasion, limited tax education, weak enforcement, and the prevalence of informal business activities that fall outside the tax net. However, recent reforms, including digitalization of the tax administration process and the

amendment of tax laws through the annual Finance Acts, have contributed to improving tax collection efficiency and expanding the tax base.

Overall, the Company Income Tax remains a vital component of Nigeria's fiscal policy and economic development strategy. It not only provides revenue for the government but also serves as a tool for economic regulation, income redistribution, and the promotion of sustainable business practices. Thus, company Income Tax (CIT) is a tax levied on the profits of companies in Nigeria, including oil and gas firms. The rate of CIT for non-petroleum companies is set at 30%, though there are certain exemptions and tax reliefs for qualifying companies (FIRS, 2023). For oil companies, the CIT rate is lower, but they are subject to additional taxes, including Petroleum Profit Tax (PPT) (PwC Nigeria, 2021).

4.2 Impact of Petroleum Profit Tax (PPT) on Profitability in Nigeria

The Petroleum Profit Tax (PPT) has a substantial impact on the profitability of oil and gas companies operating in Nigeria, given its high tax rates and extensive compliance requirements. As one of the highest corporate tax regimes globally, PPT directly influences how much of a company's earnings can be retained as profit after tax obligations are settled. The most immediate impact of PPT on profitability arises from its high tax rates, which can reach up to 85% of chargeable profits for companies in joint venture arrangements. Even newer companies or those under production sharing contracts face a tax rate of 65.75%, significantly reducing the net income available to shareholders and reinvestment. In practical terms, this means that for every dollar of profit earned by a petroleum company, a substantial portion goes to the federal government in the form of taxes. This tax burden can discourage foreign direct investment and reduce the internal capital available for operational expansion and infrastructure development (PwC Nigeria, 2022).

Moreover, PPT allows for deductions of certain expenses incurred in petroleum operations, which theoretically should ease the tax burden. However, the strict definition of allowable expenses, which excludes general overheads, depreciation, and other non-core expenditures, limits the deductions that can be claimed. This often results in a higher effective tax rate than anticipated and compresses margins further (Deloitte Nigeria, 2021). Companies that fail to maintain comprehensive and defensible financial records may also suffer from disputed tax assessments, leading to additional penalties and interests that negatively affect profitability.

The unpredictability of crude oil prices also compounds the impact of PPT on profitability. Since PPT is based on profits, any drop in international oil prices reduces revenue, but the fixed and operational costs of production remain high. When prices fall, the tax burden may consume a larger portion of profits or even lead to losses, especially for marginal fields and smaller operators. This volatility makes it difficult for companies to plan financially, further affecting their bottom line (Hassett & Hubbard, 2002). Additionally, PPT compliance involves extensive reporting and administrative costs, including the preparation of detailed tax returns, audits, and negotiation with tax authorities. These compliance costs, both in terms of finance and time, reduce the operational efficiency and profitability of affected firms. Delays in resolving disputes with the Federal Inland Revenue Service (FIRS) or uncertainty around tax interpretations can tie up resources and create an unpredictable business environment.

The cumulative fiscal obligations imposed on petroleum companies—comprising PPT, royalties, the Nigerian Content Development levy, the Niger Delta Development Commission

(NDDC) levy, education tax, and other sector-specific charges, create a heavy tax burden. This has prompted many operators to lobby for fiscal reforms or seek more favorable terms in their agreements with the government. The Petroleum Industry Act (PIA) 2021 was introduced in part to address these issues by restructuring the petroleum taxation system to improve clarity and reduce the disincentive to invest. By replacing PPT with Hydrocarbon Tax and Companies Income Tax under the new framework, the government aims to create a more investor-friendly environment that can stimulate long-term profitability and sustainability in the sector. However, the transition period may still carry uncertainties and costs that could temporarily affect profitability until the new system is fully operational and understood by stakeholders.

The Petroleum Profit Tax significantly affects the profitability of oil companies in Nigeria through high tax rates, limited allowable deductions, compliance costs, and exposure to market volatility. While recent reforms under the PIA aim to improve this landscape, the legacy of PPT continues to influence operational and investment decisions in the Nigerian petroleum sector (Brennan, 2012).

The CIT reduces the amount of taxable income available for firms to reinvest in their operations or distribute as dividends. As taxes increase, firms face higher costs, which can lower profitability, especially for firms in capital-intensive sectors like oil and gas (Brealey & Myers, 2011). The imposition of high CIT can discourage investment, as firms may prioritize tax avoidance or tax planning strategies over long-term strategic projects. Reduced investments in exploration and development could lead to lower future profitability (Brennan, 2012). CIT can also impact the operational efficiency of oil and gas companies. Firms may opt for tax-efficient measures that do not necessarily align with optimal business operations, resulting in inefficiencies that affect profitability (Hassett & Hubbard, 2002).

4.3 Petroleum Profit Tax (PPT) in Nigeria

The Petroleum Profit Tax (PPT) is a tax imposed on the profits of companies involved in the extraction of petroleum resources in Nigeria. The rate for PPT is typically higher than the CIT rate and ranges from 50% to 85%, depending on the specific conditions and agreements between the government and oil companies (FIRS, 2023). Petroleum Profit Tax (PPT) in Nigeria is a specialized form of corporate taxation applied exclusively to companies engaged in petroleum operations, which include the exploration, drilling, production, and sale of crude oil and natural gas. This tax is governed by the Petroleum Profits Tax Act (PPTA), Cap P13, Laws of the Federation of Nigeria 2004, and administered by the Federal Inland Revenue Service (FIRS). PPT is one of the most significant sources of government revenue in Nigeria due to the country's heavy reliance on crude oil exports as a primary economic driver.

Unlike Company Income Tax, which applies to all companies outside the petroleum sector, PPT is specifically tailored to the unique characteristics of the oil and gas industry. The Act defines petroleum operations as activities carried out under a license or lease for the purpose of winning, extracting, and disposing of crude oil. The tax applies only to upstream operations and does not cover downstream activities such as refining or distribution (Deloitte Nigeria, 2021). The tax rate under the PPTA varies depending on the nature of the company's agreement with the government and the date of commencement of operations. For companies operating under Joint Venture (JV) arrangements, the applicable tax rate is 85% of chargeable profits. However, for companies in production sharing contracts (PSCs) and those in their first five years of operation under JV arrangements, a reduced tax rate of 65.75% is applicable.

These rates are considered among the highest in the global petroleum industry and are justified by the high profitability of oil exploration in Nigeria.

Chargeable profits for PPT purposes are calculated by deducting allowable expenses from the total income generated from petroleum operations. These allowable deductions include expenses that are wholly, exclusively, and necessarily incurred in the process of petroleum operations. Common deductible items include costs related to drilling, exploration, transportation, salaries, and contributions to government-approved pension schemes. However, certain expenses such as depreciation, fines, and expenditures not directly related to petroleum operations are not allowable for PPT purposes.

In addition to PPT, Ola (2020) noted that companies involved in petroleum operations are also subject to other levies and contributions, including royalty payments to the government based on volume of crude oil extracted, the Niger Delta Development Commission (NDDC) levy, education tax, and Nigerian Content Development levies. These cumulative fiscal obligations significantly increase the total tax burden on oil companies operating in Nigeria. The administration of PPT requires companies to file returns with the FIRS, which include detailed computations of assessable tax, chargeable profits, and evidence of payments. These returns must be filed within five months after the end of the accounting period, usually the calendar year, and must be accompanied by audited financial statements. Failure to comply with the filing and payment requirements attracts penalties, interest charges, and in some cases, prosecution.

Despite its fiscal importance, the PPT regime has faced numerous challenges over the years. These include legal ambiguities in the tax legislation, prolonged disputes between tax authorities and multinational oil companies, and issues related to tax avoidance and transfer pricing. The complexity of petroleum contracts and the discretionary nature of cost recovery in PSCs have further complicated PPT administration. Additionally, the volatility of global oil prices often affects the predictability and stability of petroleum tax revenues. To address some of these challenges and modernize the petroleum taxation framework, PwC Nigeria (2022) established that the Nigerian government enacted the Petroleum Industry Act (PIA) in 2021. The PIA introduces a new fiscal regime that gradually phases out PPT and replaces it with two new taxes: the Hydrocarbon Tax (HT) and the Companies Income Tax (CIT) under a unified fiscal framework. The Hydrocarbon Tax applies only to crude oil production and excludes natural gas, while CIT applies to all petroleum-related companies in line with the general tax structure. The new regime aims to create a more transparent, competitive, and investor-friendly environment in Nigeria's oil and gas sector.

In this context, Petroleum Profit Tax has historically played a central role in Nigeria's revenue generation and remains a key fiscal tool for regulating the oil and gas industry. However, with the enactment of the Petroleum Industry Act, the structure of petroleum taxation in Nigeria is undergoing significant reform to ensure long-term sustainability, improved compliance, and greater alignment with international best practices (Federal Inland Revenue Service, 2020).

Oil companies in Nigeria face a higher tax burden due to the PPT. This tax significantly reduces the profits of firms, especially those that are not making significant revenues or are facing declining oil prices. As a result, profitability can be severely constrained by this higher tax liability (Adenikinju, 2018). The PPT creates a situation where oil firms must

adjust their cost structures to offset the impact of high tax liabilities. This can result in reduced profit margins, which may affect overall profitability (Alao & Olaniyan, 2019).

The high rate of PPT can also discourage investment in the sector, as firms may prefer to divert capital to markets with more favorable tax regimes. This, in turn, impacts the long-term growth prospects and profitability of these firms (Ally, 2017).

4.4 Profitability of Listed Oil and Gas Firms in Nigeria

The profitability of listed oil and gas companies in Nigeria reflects the complex interplay of global oil market dynamics, domestic fiscal policies, operational efficiency, and regulatory frameworks. These firms, which are typically listed on the Nigerian Exchange Group (NGX), include major players such as Seplat Energy Plc, TotalEnergies Marketing Nigeria Plc, Conoil Plc, and Ardova Plc. Over the years, their financial performance has been subject to fluctuation due to changes in crude oil prices, the fiscal regime (notably the Petroleum Profit Tax), foreign exchange volatility, and domestic operational challenges (Nigerian Exchange Group, 2023). Global Oil Prices and Revenue Generation. Since oil is priced in U.S. dollars on the international market, the revenue generation capacity of Nigerian oil and gas companies is heavily influenced by global oil prices. High oil prices generally result in increased revenue and gross profits for upstream companies like Seplat, which engages in exploration and production. However, downstream companies such as TotalEnergies and Ardova, which focus on refining, marketing, and distribution, often face slimmer margins due to regulated pricing, subsidy regimes, and logistics inefficiencies.

Fiscal Pressure and Tax Burden. The Petroleum Profit Tax (PPT), alongside other sector-specific levies and royalties, significantly affects the bottom line of these firms. High effective tax rates reduce the net profit margins of upstream companies. For instance, Seplat Energy has reported that fiscal terms under previous regimes have affected reinvestment decisions and long-term project financing. The Petroleum Industry Act (PIA) 2021, which is currently being implemented, is expected to ease some of these pressures by introducing a more competitive tax and regulatory structure, thereby potentially improving profitability over the medium to long term. **Exchange Rate Volatility and Operating Costs** Oil and gas firms in Nigeria often report earnings in naira while incurring a significant portion of their operational costs, especially in the upstream segment, in U.S. dollars. With continued depreciation of the naira and FX market instability, firms face increased cost burdens that erode profit margins (Seplat Energy, 2022). Moreover, delays in accessing foreign exchange through official channels can disrupt operations and financial planning.

Operational Efficiency and Cost Management Profitability also depends on how efficiently these companies manage their operations. Seplat Energy, for example, has consistently invested in technology and infrastructure to enhance its production efficiency, reduce gas flaring, and improve cost control, which has positively impacted its EBITDA and profit after tax. On the other hand, some downstream firms like Ardova Plc have struggled with high operating expenses, infrastructural limitations, and intense market competition, which have contributed to periodic declines in profitability (TotalEnergies Marketing Nigeria, 2022).

Regulatory Environment and Market Liberalization. The recent efforts to deregulate the downstream oil sector, including the planned removal of fuel subsidies, could boost profitability prospects for marketing and distribution firms. If fully implemented, deregulation would allow these companies to adjust retail prices to reflect market realities, thereby

increasing revenue potential. However, the transition may also expose companies to public backlash and market volatility in the short term. Financial Performance Trends. A review of audited financial reports from 2020 to 2023 indicates mixed profitability performance among listed oil and gas companies. Seplat Energy Plc consistently posted profits, with profit after tax figures exceeding ₦40 billion in 2022, supported by strong oil prices and improved production volumes. In contrast, firms like Ardova and Conoil have seen profit fluctuations due to cost inefficiencies, FX losses, and tighter margins. TotalEnergies Marketing Nigeria Plc, leveraging its strong distribution network and diversified product line, has managed to remain consistently profitable, though with modest profit margins (Nigerian Exchange Group, 2023).

In this contestation, the profitability of listed oil and gas firms in Nigeria is shaped by both external and internal factors. While high global oil prices and reforms under the PIA offer opportunities for growth, challenges such as fiscal burdens, FX volatility, and infrastructural inefficiencies continue to constrain performance. Moving forward, firms that can adapt to regulatory changes, improve operational efficiency, and leverage innovation are more likely to achieve sustained profitability in Nigeria's evolving oil and gas landscape.

V. Conclusion

The impact of Company Income Tax (CIT) and Petroleum Profit Tax (PPT) on the profitability of listed oil and gas firms in Nigeria is multifaceted. While taxes are essential for revenue generation and government funding, they can also have detrimental effects on the profitability of firms in the oil sector. High tax rates reduce the available capital for investment, increase operational costs, and can distort decision-making. Therefore, there is a need for a more balanced and efficient tax policy that takes into account the economic realities of the oil and gas sector, while ensuring that firms remain profitable and sustainable.

Recommendations

Based on the findings of this study, the researcher makes the following recommendations:

1. The Nigerian government should consider introducing tax incentives, such as tax holidays or reduced rates for oil firms investing in sustainable technologies or new exploration projects.
2. The government should review the petroleum profit tax regime to ensure it is competitive and conducive to business growth, without undermining the national revenue base.
3. Policies that encourage oil companies to reinvest profits into exploration, development, and innovation could help mitigate the negative impact of taxes on profitability.

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