

FIRS, the recent court ruling and the best of judgement question

What is the extent of FIRS' powers, if any, to deem the income tax payable by a company?



By Taiwo Oyedele

Section 30 of CITA grants the FIRS powers to charge a company to tax on a fair and reasonable percentage of turnover as contained in the company's returns, it does not grant the FIRS powers to deem a company's turnover.

Where a company fails to file a return, the relevant provision is section 65(3) of CITA which empowers the FIRS to deem a company's total (taxable) profits using its best of judgement. Again this section does not empower the FIRS to deem a company's turnover.

Context

Paying taxes is difficult, especially when taxpayers don't have much to show for the taxes they pay. But to deliver social services government needs tax. Balancing these two conditions can be a daunting task.

If for whatever reasons people don't pay their taxes, does government have the right to compel them and if so to what extent can this power be exercised? This is the thrust of a recent court case between the Federal Inland Revenue Service (FIRS) and a taxpayer alleged to have defaulted in filing returns and paying taxes.

Facts of the Case

FIRS assessed Theodak Nigeria Limited, a company engaged in the letting of office premises, to tax by deeming the value of the company's property as its turnover and then deemed 20 percent of the value as the taxable profit on which the tax rate of 30 percent was applied to determine the tax payable relying on section 30(1)(a) of the Companies Income Tax Act (CITA). Although not originally stated as the basis for the assessment, the FIRS also made reference to section 65 of CITA in its defence.

The company challenged the assessment and asked the Federal High Court (FHC) to declare the assessment invalid and restrain FIRS and/or its agents from taking steps to enforce the assessment.

Parties' positions

The company argued that FIRS lacks the power to assess it to tax based on the value of its property since section 30(1)(a) requires the assessment to be on a company's turnover. The company further argued that "value of property" is not income chargeable to tax under CITA.

The FIRS argued that it has the power under the section to employ a best of judgement (BOJ) assessment to determine a company's profits and assess the profits to tax. It also argued that the company did not object to the assessment within 30 days of receipt making the assessment final and conclusive in line with section 69(1) of CITA.

The Federal High Court (FHC) Decision

The FHC held that though section 30(1)(a) allows FIRS to assess the company to tax on turnover, the value of the company's property cannot be used as turnover unless the company is in the business of selling properties and had disposed that particular property.

The FHC also held in interpreting section 69(1) of CITA that a taxpayer is not required to object to an assessment within 30 days of receipt because the word 'may', connoting a discretion, is used in the section. So, failure to object within 30 days cannot deny the company access to the court.

The relevant sections of CITA

Section 30(1)(a) grants the FIRS power to assess and charge a company to tax on a fair and reasonable percentage of the turnover of the trade or business as the Board (FIRS) may determine where:

- (a) it appears to the FIRS that a company has no “assessable profits” or;
- (b) the assessable profits, in FIRS’ opinion, are less than might be expected to arise from that trade or business; or
- (c) the true amount of the assessable profits of the company cannot be ascertained.

Section 65(3) provides that where a company has not delivered a return and the Board (FIRS) is of the opinion that such company is liable to pay tax, the FIRS may, according to the best of its judgement, determine the amount of the “total profits” of such company and make an assessment accordingly ...

Section 69 says if any company disputes the assessment it may apply to the FIRS, by notice of objection in writing, to review and to revise the assessment made upon it. The application shall be made within 30 days from the date of service of the notice of assessment ...

Critical questions arising from the above sections of the law

What is turnover? – Given that turnover is not defined in CITA, it will take its ordinary or technical meaning. Based on Accounting Standards, turnover is the net sales generated by a business arising from the ordinary activities of the entity. Interestingly section 30(1)(a) of CITA does not empower the FIRS to deem a company’s turnover but rather to assess and charge a company to tax based on a fair and reasonable portion of “the turnover” (as contained in the company’s returns). FIRS has over time erroneously interpreted this section to mean that it has powers to deem a company’s turnover.

So, what if a company fails to file returns? – In this case, the relevant provision is not section 30(1)(a) but section 65(3) which empowers the FIRS to determine the “total profits” of a company liable to tax and had failed to file a return to the FIRS.

How is “assessable profits” used in section 30 differ from “total profits” used in section 65? – Generally, the difference is the treatment of capital allowances. While the former is before relief for capital allowances the latter is after. The logic is that a company that files a return (under section 30) should already provide information about its assets and capital allowances hence it

will be counter intuitive for FIRS to deem what is already a matter of fact. What FIRS is required to do is deem the “assessable profits” and then relief the actual capital allowance due to the company in order to arrive at the total profits on which tax is charged. On the other hand, where a company has not filed a return (under section 65) and therefore has reported neither its turnover nor capital allowances, the FIRS is empowered to use its best of judgement to deem the company’s total (taxable) profits on which tax will be charged.

How does best of judgement (BOJ) work? – The use of the word “best” presupposes that the judgement (or opinion) must be based on sound analyses and careful consideration in line with the principles of natural justice and must reflect the reality as reasonably possible. This means the judgement cannot be arbitrary. In fact it should not be the same for different companies and may even differ for the same company from one year to another. Therefore the use of a standard percentage of turnover by the FIRS to assess all companies is at best a judgement but certainly not the best of judgement.

Deductions and conclusions

From the above analyses and the FHC decision, the following can be established:

1. The FIRS has no powers to deem a company’s turnover under any circumstance. Its power is to deem assessable or total profits under different circumstances.
2. The powers granted under S30 is with respect to where returns containing assessable profits have been filed by a company but not to the satisfaction of the FIRS in which case it may assess and charge the company based on a fair and reasonable percentage of its turnover.
3. In the event that a taxpayer fails to file tax returns (thereby making it impossible to deem assessable profit based on its turnover) the law empowers the FIRS to deem the total (taxable) profits in line with section 65(3) using its best of judgement.
4. Best of judgement must be exercised in line with principles of natural justice, it cannot be arbitrary.
5. Where there is an assessment, the taxpayer has the discretion to object or to appeal. The use of the word “may” means discretion between options to either object to the FIRS or to appeal to the court.

6. An assessment must be valid to be capable of becoming final and conclusive as one cannot build something on nothing.
7. With respect to objection under section 69, even though the FHC held that it is not mandatory for a taxpayer to object to an assessment, my view is that a taxpayer who decides not to object to the FIRS must appeal to the Tribunal/Court within 30 days of receipt. This is consistent with Paragraph 13 of the 5th Schedule to the FIRS (Establishment) Act (which overrides CITA).
8. Based on the Constitution, even where an assessment has become final and conclusive

the taxpayer cannot be denied the right of access to the court. What the outcome would be is entirely a different issue.

My closing thoughts

While this decision by the FHC challenges some of the long held practices of the FIRS, it also raises a number of unanswered questions. As businesses continue to evolve in a dynamic and progressive world, the laws applied in taxing them should not be outdated and retrogressive. This therefore calls for an urgent review of the tax laws.

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