PwC Tax Alert

FIRS Circular on the taxation of companies engaged in international shipping, air transport and cable operations

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Background

Pursuant to the amendments made by Finance Act 2020, the FIRS has issued a circular (Circular 2021/14) on the taxation of companies engaged in shipping, air transport, and cable undertakings. This withdraws and replaces the previous Circular 2019/11 of 21 October 2020 on the same subject. We have highlighted and discussed the key matters from the circular below:

Highlights of the circular

Basis for ascertaining assessable and total profits

1. **Nigerian Companies:** In line with Section 13(1) of CITA, Nigerian companies engaged in shipping, air transport or cable undertakings are subject to tax based on their worldwide income, regardless of whether or not the income was received in or brought into Nigeria.

2. **Foreign Companies:** For Non-Resident Companies (NRCs) that carry out shipping, air transport or cable operations, the Circular highlighted as follows:

a) **Under domestic tax laws:** Section 14 of CITA contains specific rules for dealing with the taxation of profits of NRCs that carry out international shipping, air transport or cable operations, in Nigeria. The FIRS' interpretation of these rules are as follows:

- Profits of foreign airlines or shipping companies derived from Nigeria are taxable in Nigeria.
- Such profits may either be: ***a) freight income*** or ***b) non-freight income***. Section 14 will apply on freight income (income from the carriage of passengers, mails, livestock or goods shipped, or loaded into a ship or an aircraft in Nigeria). In this regard, only the outbound freight income from Nigeria will be taxed under this Section.
- Section 14 will not apply to non-freight income (income from other activities including commission, demurrage, clearing fees, container damage fees, stevedoring, and so on). Instead, such income will be taxable in line with the taxable presence (or "Permanent Establishment") rules in Section 13(2) of CITA.
- The FIRS also clarified that such non-freight or ancillary activities are subject to VAT as applicable.
- Any profits arising from the transshipment of passengers, livestock or other items are not chargeable to tax in Nigeria.

The FIRS' interpretation of the ways of computing the NRC's profits are:

- Based on the financial statements submitted with respect to Nigerian operations;
- Where the NRC is resident in a country with similar CIT assessment rules to that of Nigeria, the FIRS can adopt the foreign country's profit ratios to total revenue, and apply such ratios on the NRC's revenue sourced from Nigeria, in line with Section 14(2) of CITA;
- Where Section 14(2) cannot be applied, the FIRS is empowered to deem the profits on the revenue sourced from Nigeria for tax purposes, in line with Section 14(3). In practice, this is usually deemed at 20%.
- Notwithstanding any of the 3 approaches above, the minimum tax payable by the NRC is 2% of their outbound freight from Nigeria.

b) **Where there is a Tax Treaty:** Where an NRC that carries out shipping and air transport activities is domiciled in a country which has a Double Taxation Agreement (DTA) with Nigeria, such NRC will be subject to tax based on the Article on Shipping and Air Transport in the relevant treaty. However, the treaty relief will only apply to the activities specifically listed in the DTA, and any other income will be considered under the Article on Business Profits and will be subject to tax accordingly. Also, for DTAs that require reciprocity (i.e companies resident in both countries must operate in the other country) ships and aircrafts are not interchangeable in meeting the conditions for the treaty relief.

Filing of CIT returns

In line with Section 55 of CITA, all companies including NRCs are required to submit tax returns to the FIRS, which will include the following:

- Global consolidated audited financial statements of the company;
- Financial statement relating to Nigerian operations, attested by an independent qualified accountant in Nigeria;
- Tax computation schedules;
- True and correct statement of profits attributable to Nigerian revenue sources;
- Completed CIT Self-Assessment forms;
- Evidence of payment of tax due if any.

Advance payment of tax

Shipping and Airline NRCs are required to make advance tax payments on a monthly basis, computed at 2% of their Nigeria-sourced revenue, supposedly in line with Sections 14(4) and 81 of CITA. The FIRS highlights that this monthly payment is not final tax, and does not preclude the NRC from its annual CIT compliance obligations.

Income from leasing of ships and aircrafts

The FIRS clarified that in the absence of a DTA, where an NRC earns income from leasing ships or aircrafts, such income does not relate to the operation of ships or aircrafts and therefore is not taxable under Section 14 of CITA. Rather, such income is treated as non-freight income and is taxed under the relevant CITA rules. This is regardless of whether the lessor retains ownership of and manages the ship/aircraft (such as in a time/voyage or operating/wet lease arrangement), or if this is passed on to the lessee for the specified period (such as in a bareboat/demise or dry/finance lease arrangement).

However, where the NRC is resident in a treaty country, time/voyage or operating/wet lease income will fall under the Article on Shipping and Air Transport, while bareboat/demise or dry/finance lease income will be treated as non-freight income, unless specifically included by the DTA.

Taxation of NRC vessels that lift Nigerian petroleum products

The FIRS highlighted that foreign shipping companies contracted by foreign buyers of Nigerian petroleum products from Nigeria, are liable to CIT in Nigeria in line with Section 14 of CITA. This is irrespective of where the carriage contract was executed.

Capital Gains Tax (CGT)

In the absence of a DTA, CGT will apply on any capital gains on the disposal of a ship or aircraft used in international traffic (notwithstanding the physical location of the asset), where:

- the owner of the ship or aircraft is resident in Nigeria; or
- a resident of Nigeria owns an interest in or right in the ship or aircraft.

For gains on disposal of vessels and aircrafts not used in international traffic, CGT will apply if either the vessels/aircrafts or their owners are physically located in Nigeria.

Where a DTA exists, a non-resident will only be subject to CGT in Nigeria where the aircrafts/vessels are not used in international traffic and the aircrafts/vessels are located in Nigeria at the time of the disposal and constitutes permanent establishments (PE) for the non-residents.

Claim of treaty benefits

The FIRS reiterated that shipping and airline NRCs resident in treaty countries will need to obtain administrative clearance from the FIRS to obtain DTA benefits in Nigeria. Please see our previous Tax Alert in this regard, here.

Message transmission operations

In line with Section 15 of CITA, the FIRS highlighted that NRCs engaged in the transmission of messages by cable or other wireless means within Nigeria, will be subject to similar CIT assessment rules as shipping and airline NRCs.

Takeaway

The request by the FIRS for Shipping and Airline NRCs to include their home-country/global financial statements (FS), together with a financial statement for their Nigerian operations that has been attested to by a qualified accountant in Nigeria is not exactly in line with the law. Section 55(1A) of CITA only makes this a requirement for an NRC that *"derives profit from or is taxable in Nigeria under section 13 (2) of this Act…"*, meaning that this should apply to only companies that create a traditional taxable presence or Significant Economic Presence (SEP) in Nigeria, under the relevant sub-section.

The relevant filing requirement for foreign shipping and airline companies is Section 55(1) which only requires such NRCs to submit audited financial statements (without including their global FS).

Section 33 of CITA includes a general minimum tax provision for companies, assessed at 0.5% of companies' gross turnover (subject to certain exemptions). However, Section 14 of CITA also includes a 2% minimum tax on the outbound freight income of Shipping and Airline NRCs. Based on legal principles and as clarified by the FIRS, the general minimum tax provision should not apply on freight income earned by Shipping and Airline NRCs, as this is specifically covered by Section 14.

Also, the FIRS clarified that non-freight and other ancillary income earned by Shipping and Airline NRCs are subject to VAT in Nigeria, but was silent on international freight activities. This should imply that VAT does not apply on international air and sea transportation.

With regards to CGT, the FIRS highlighted that where a DTA exists and the aircrafts/vessels are not used in international traffic, CGT applies if the asset constitutes a PE and is in Nigeria at the time of disposal. However, the application of CGT in all DTA situations should not depend on whether a PE exists. Also, CGT requirements are not uniform across all DTAs, and each treaty needs to be considered for relevant transactions. Taxpayers should be aware that circulars are not law and cannot be relied on if they are inconsistent with law, in line with judicial precedents.

In addition, it may have been preferable if the FIRS provided additional guidance on the application of the rules to NRCs engaged in the transmission of messages under Section 15 of CITA. There may be questions around the current relevance of this provision, considering the recently introduced Digital SEP rules, which seem to address similar grounds. However, it is considered that NRCs that provide telecommunication or network-related services should remain taxable under Section 15. Other issues may be whether the reference to "transmission of **messages**" refers to the transmission of all forms of data, and how to practically delineate outbound from inbound transmission for CIT purposes.

For a deeper discussion, please contact any member of our Tax team below:

Kenneth Erikume
Tax Partner
kenneth.y.erikume@pwc.com

Emeka Chime
Associate Director
chukwuemeka.x.chime@pwc.com

Olanrewaju Alabi
Senior Manager
olanrewaju.alabi@pwc.com

Dozie Adibe
Manager
dozie.adibe@pwc.com