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Tax Controversy & Dispute Resolution

Insight Series

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Welcome

This publication is intended to keep you abreast of recent tax cases from the Tax Appeal Tribunal and Federal High Court. Some of the decisions analysed in this publication include cases relating to the extent of the executive's power to make or amend tax statutes, applicability of Double Tax Treaty Commentary to the France-Nigeria Double Tax Treaty with respect to income from shipping operations, the applicability of Value Added Tax to commercial and residential leases as well as the precedent setting decision on the applicability of Withholding Tax to sales in the ordinary course of business, an appeal in which our Tax Controversy & Dispute Resolution team represented the taxpayer.

If any of these cases impact you or your operations directly or indirectly, we would be delighted to discuss them further with you. Please contact any member of our Tax Controversy & Dispute Resolution teams.

We expect to see some disputes arising from the introduction of new legislation, particularly the Significant Economic Presence Order 2020 and other contentious changes in the Finance Acts 2019 and 2020. It is instructive to note that the Finance Act 2020 has introduced amendments which directly impact some of the cases discussed in this publication – one example is the expansion of the categories of taxable income of shipping companies and airlines. Another amendment by the Finance Act 2020 introduced virtual hearing by the Tax Appeal Tribunal through electronic means.

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CMA CGM Delmasa SA v. FIRS

TAT/LZ/CIT/028/2017

Tax Appeal Tribunal rules that Commentary to Model Tax Convention is not applicable to Article 8 of the France-Nigeria Double Tax Treaty

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Background

Section 14 of CITA provides special rules for taxing income from shipping activities which limits the taxable profit to income from outbound transport.

Article 8 of the OECD Model Tax Convention (MTC) allocates the taxing rights to the resident state of a shipping company on income arising from Shipping and Air Transport (in international traffic). The Double Tax Treaty (DTT) between France and Nigeria is modelled after the MTC. However, Article 8(2) of the DTT deviates from Article 8(2) of the MTC. It provides that income derived by the resident of a State from such activities in another State are exempt from tax in the other State, but where enterprises of only the State of resident carry on international traffic, tax at 1% of "earnings" is to be imposed by the other State from which the income is earned. MTCs are always supplemented by Commentaries which are intended to aid interpretation of DTTs modelled after the MTCs. These Commentaries are updated from time to time.

Facts of the appeal

In *CMA CGM Delmasa SA v. FIRS*, the taxpayer, an international shipping company, earned income from shipping activities including carriage of goods, demurrage, container cleaning, shipping line agency charge (SLAC), bonded terminal commission etc. FIRS assessed the taxpayer to tax on the income of over N1 billion for the years 2014 and 2015. The FIRS issued a notice of refusal to amend after the taxpayer objected.

Questions before the Tribunal

The questions for determination before the Tribunal were:

- Whether the sums in dispute (demurrage, cleaning fees, container sales, shipping line agency commission, bonded terminal commission and NIMASA levy), being directly connected and ancillary to the carriage of goods from foreign countries into Nigeria are taxable in Nigeria?

- Whether the Appellant is liable to penalty and interest in respect of the sums in dispute?

Taxpayer arguments:

- By Article 8 of the DTT and the accompanying Commentary, such income, being ancillary to in-bound freight were exempt from tax in Nigeria,
- According to the MTC Commentary, income from ancillary or non-freight activities such as leasing of containers, storage etc. are defined as arising from international traffic so are tax exempt.
- Interest and penalty would not apply given that the assessment had not become final and conclusive.

FIRS' arguments:

- By specifically listing the exempt income, Article 8 does not extend to non-freight income therefore such income would be taxable under the CITA regardless of whether they arise from in-bound or out-bound transport,
- Since Nigeria was not a member of the OECD, the Commentaries could not be relied on to interpret the France-Nigeria DTT,
- The taxpayer was subject to interest and penalty for failure to pay the tax in question as and when due.

The decision

The Tribunal held that based on treaty supremacy, the DTT would apply in place of section 14 of CITA. However:

- the Commentaries were supplementary to DTTs and provided guidance only when the provisions of the DTT are similar with the MTC,
- in this appeal, Article 8 of the DTT was substantially different from Article 8 of the MTC therefore the Commentaries could not be relied on to interpret Article 8,
- the income in question – non-freight income was not covered by the provisions of Article 8 therefore, the income was subject to tax under CITA,
- Finally, interest and penalty only stop to accrue once an appeal is filed but they attach upon payment of tax as and when due.

Analysis and takeaway

The crux of the appeal was whether the Commentaries to the MTC would apply when interpreting Article 8 of the France-Nigeria DTT. The question of whether the Commentaries are binding would usually depend on whether the Commentaries are static (extant at the time of negotiating the DTT) or ambulatory (amended after the DTT has come into force).

Generally, Commentaries in existence at the time DTTs are negotiated should be relied on by courts when interpreting DTTs. The rationale is that States are presumed to have intended to be bound by these except they registered reservations during treaty negotiations. Ambulatory commentaries may also be binding if it can be established that during treaty negotiations Contracting States expressed an intention to be bound by the terms consistent with the updated commentaries.

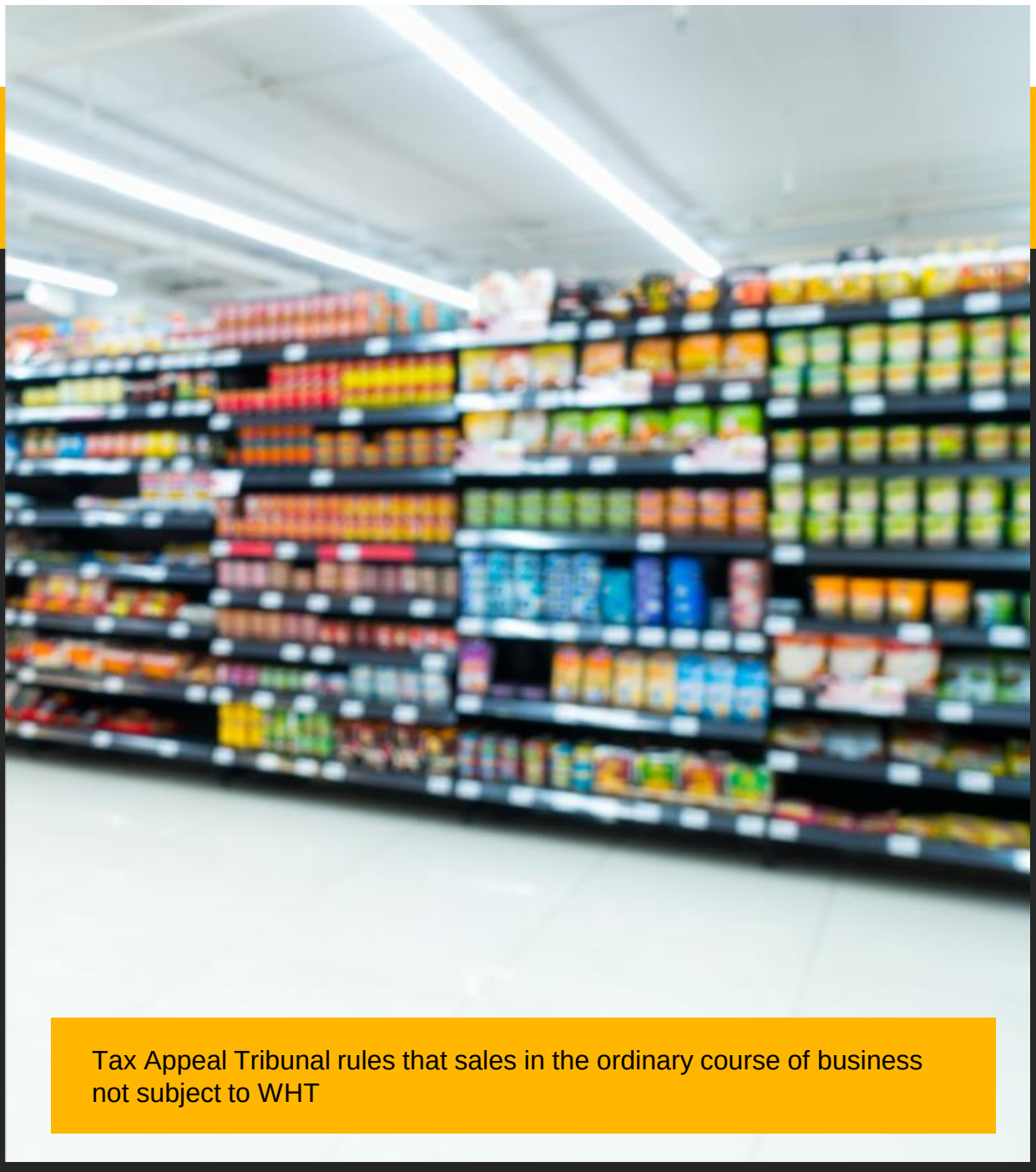
It is also necessary to note that courts and tribunals may be reluctant to apply Commentaries where the provisions in DTTs are not identical with the MTC. So, taxpayers intending to rely on the Commentaries must inquire whether DTT provisions are consistent with the text of the MTC. They must also find out whether any of the Contracting States made reservations or objections during negotiations. Where there are reservations or objections, it is less likely that the Commentaries are binding.

However, an examination of Article 8(1) of both the DTT and MTC show that both Articles are similar as they both allocate taxing rights to the State of residence of the shipping company. Therefore, the Commentary to Article 8(1) which defines the "profits" of such companies to include profits arising directly or ancillary to shipping operations such as renting containers, providing services etc. should be relevant for the purpose of interpreting Article 8(1) and the Tribunal should have relied on it. Taxpayers may, as an alternative to litigation, also explore the Mutual Agreement Procedure under DTTs.

It is instructive that the Finance Act 2020 has introduced a new subsection (5) to the section 14 of CITA which expands the category of taxable income of shipping and airline companies. Per the amendment, all incidental or non-freight income such as leasing income are taxable under CITA. It will be interesting to see how the amendment impacts Article 8 of DTTs.

Tetra Pak v. FIRS

TAT/LZ/WHT/007/2019



Tax Appeal Tribunal rules that sales in the ordinary course of business not subject to WHT

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Background - legal basis and FIRS practice

The Companies Income Tax (Rates, Etc., of Tax Deducted at source) Regulations 1997 (WHT Regulations) requires that tax is withheld on payment for certain qualifying services. The rates are either 2.5%, 5% or 10% depending on the specific service.

The WHT Regulations provide that *"all types of contracts and agency arrangements other than sales in the ordinary course of business"* are subject to WHT at 5%. This means that sales in the ordinary course of business would not be subject to WHT. However, the WHT Regulations do not define what amounts to "sales in the ordinary course of business" (SITOCOB).

However, the Federal Inland Revenue Service (FIRS) takes the view that taxpayers must deduct WHT on all payments constituting a contract whether or not they are in respect of "sales in the ordinary course of business". This imposes a practical burden on low margin businesses (like trade and manufacturing). To avoid assessments and penalties from FIRS, many businesses that make such purchases deduct WHT on the payments.

Facts of the appeal

The principal activities of Tetra Pak ("the Company") involved importing and sale of packaging equipment and spares, installing equipment and providing after sales repairs.

The Company's customers deducted WHT on its fees for sales provided in the ordinary course of its business. As a result, the Company paid companies income tax (CIT) via WHT in years where it did not make a profit. This impacted the Company's cash flows considering that FIRS did not refund the WHT as it is required to do by the Companies Income Tax Act (CITA) and the Federal Inland Revenue Service (Establishment) Act (FIRSEA).

To manage the impact, the Company wrote to FIRS for confirmation that such sales should not be subject to WHT. FIRS ruled otherwise relying on some WHT Information Circulars. The Company appealed to the Tax Appeal Tribunal (TAT) challenging FIRS' position and asking for a refund as well as interest on the WHT.

Taxpayer's arguments

The Company argued that:

- "SITOCOB" should be given its literal meaning since it was not defined either in CITA or WHT Regulation. In addition, FIRS was wrong to attempt to define the phrase via its Information Circulars on WHT in a manner that was inconsistent with the WHT Regulations,
- the rule of interpretation that a specific provision would override the general should be applied distinguishing SITOCOB from "all types of contracts",
- SITOCOB was a question of fact which can be determined from what a business does routinely.
- The Company further relied on a Court of Appeal decision in *Nigerian Breweries v Oyo State Board of Internal Revenue* where the court alluded to the fact that such sales should not be subject to WHT.

FIRS' arguments

Interestingly, FIRS did not deny that the Company sold packaging equipment or spares routinely. However, it argued that once a sale was completed via a formal contract, it was no longer exempt from the WHT regime but had "forayed into contract" with rights and obligations and therefore subject to WHT. In support, FIRS asked the Tribunal to apply the ejusdem generis rule.

The decision

Are SITOCOB liable to WHT - The TAT agreed with the Company that SITOCOB are not liable to WHT. In arriving at its decision the TAT held that although the WHT regime is a collection device, the primary objective is to prevent evasion. Therefore, in this case, there was no occasion for tax evasion as claimed by FIRS, since the taxpayer was not tax anonymous.

The TAT also held that SITOCOB was a question of fact and a tax authority has the responsibility of determining whether a business activity amounted to a SITOCOB. The TAT provided some guidance in determining whether an activity was a SITOCOB –

- whether the activity was contained in the memorandum and articles of association,
- the type of industry the taxpayer operates in,
- the history and antecedents of the taxpayer and
- the frequency of carrying out the activity.

Refund and payment of interest by FIRS - The TAT refused to make an order for refund of the excess WHT and interest on the ground that these were not specifically pleaded by the Company.

Review of WHT rates - From an administrative perspective, the TAT held that the WHT regime should consider the effective tax rates (ETR) of different industries before imposing WHT to ensure that companies do not suffer more tax than necessary.

Analysis and takeaway

The TAT has finally resolved a long standing, but seemingly straightforward question, of whether SITOCOB should be subject to WHT. The argument by the FIRS that once a contract is established, it would not constitute a SITOCOB is flawed because by saying "…other than sales in the ordinary course of business", the WHT Regulations acknowledge that SITOCOB are contracts but specifically excludes them from WHT. Taxpayers and tax authority can now apply the tests provided by the TAT instead of the contradictory position in various FIRS circulars.

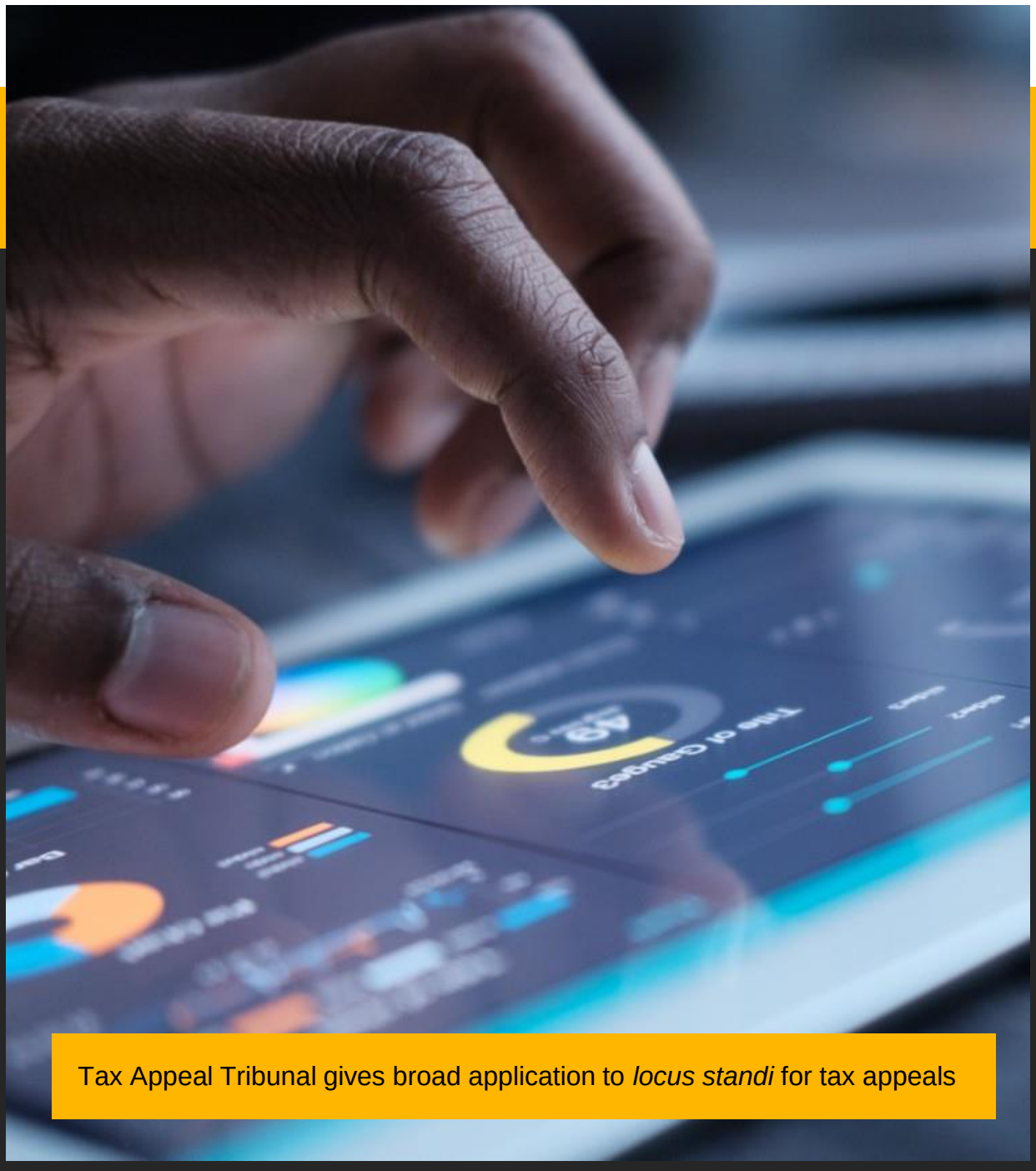
With respect to WHT remitted to FIRS before the decision, taxpayers are entitled to refunds per sections 81(7) of CITA and 40 of the FIRSEA which provide that any WHT collected should be refunded to the taxpayer within 90 days. Therefore, the authority has a responsibility to refund such taxes within 90 days.

Though the TAT did not grant the claim for a refund, there is a duty on FIRS to do so within a specific time. Therefore, to give effect to its decision. the TAT could have made a consequential order directing FIRS to refund within the statutory period any WHT wrongly remitted to and collected by the FIRS.

The TAT also commented on the legality of information circulars as being mere opinions of the tax authority on the meaning of the law as such they do not have the force of the law and are not binding on taxpayers. However, the TAT did not comment on whether, like other jurisdictions, these circulars form promissory estoppel against FIRS or whether they are sufficient to create legitimate expectations. It is possible that FIRS may appeal the decision.

Incorporated Trustees of Digital Rights Lawyers Initiative v. FIRS

TAT/LZ/VAT/031/2019



Tax Appeal Tribunal gives broad application to *locus standi* for tax appeals

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Background

Locus Standi is a Latin phrase which means 'right to sue'. It means possessing the legal capacity to file a suit or commence an action in court or a tribunal. It is also defined as having "sufficient interest" to file an action.

The issue of locus standi does not often come up in the typical tax appeal which is usually preceded by a tax assessment, a series of correspondence between taxpayer and tax authority and a Notice of Refusal to Amend issued by the tax authority.

In ***The Incorporated Trustees of Digital Rights Lawyers Initiative v. FIRS,*** the Federal Inland Revenue Service [FIRS], through a preliminary objection, challenged the Appellant's *locus standi* to file an appeal against a decision by FIRS to impose Value Added Tax (VAT) on online transactions.

Facts of the Case

On 26 August 2019, the Executive Chairman of FIRS at that time announced at a technical workshop of the African Tax Administrators Forum (ATAF) that the FIRS would ask Nigerian banks to start charging Value Added Tax (VAT) on online transactions from January 2020.

The Incorporated Trustees of Digital Rights Lawyers Initiative (ITDRLI) filed an appeal at the Tax Appeal Tribunal ('TAT' or 'the Tribunal') arguing that FIRS' decision to charge VAT on online transactions violates the provisions of sections 2,3,9 and 14 and Parts 1 and 2 of the First Schedule to the VAT Act.

In response, FIRS filed a reply challenging the jurisdiction of the Tribunal to entertain the appeal on the grounds that the Appellant lacked the necessary *locus standi* to institute the appeal and that the appeal was an abuse of the judicial process.

FIRS' arguments

FIRS' argued that at least one of the following conditions must exist before a taxpayer can file a tax appeal:

a) an assessment,
b) a demand notice by the FIRS on the taxpayer
c) an action by the FIRS and
d) a decision made by the FIRS.

FIRS further argued that ITDRLI had not demonstrated that it either had any legal right to sue for injury that it suffered by the Executive Chairman's announcement.

Taxpayer's arguments

ITDRLI argued that by virtue of Paragraph 11 of the Fifth Schedule to the FIRS Establishment Act (the Act setting up FIRS), the Tribunal has the jurisdiction to adjudicate on disputes and controversies from the VAT Act. By disagreeing with FIRS' proposed action, ITDRLI maintained that a dispute or controversy existed which could be determined by the Tribunal.

ITDRLI further argued that being a tax paying corporate citizen with a Tax Identification Number that would be affected by any VAT imposed on online transactions, it had demonstrated sufficient interest to file an appeal. Finally, ITDRIL also argued that since the appeal related to the interpretation of the VAT Act it was not frivolous.

The decision

The Tribunal held that:

- paragraph 11 of the Fifth Schedule to the FIRS Establishment Act vests the Tribunal with jurisdiction to adjudicate on ***disputes*** and ***controversies*** arising from the VAT Act. In the instant appeal, disputes would include all proclamations, notices and steps taken by relevant tax authorities in Nigeria.
- *Locus standi* should be construed liberally so as not to deny taxpayers access to the Tribunal.
- The decision to charge VAT on online transactions will affect all Nigerians including ITDRLI. Therefore, ITDRLI has sufficient *locus standi* to challenge FIRS' proposed action as announced by FIRS' Executive Chairman.

The Tribunal therefore ruled that it had the jurisdiction to hear the appeal on its merit.

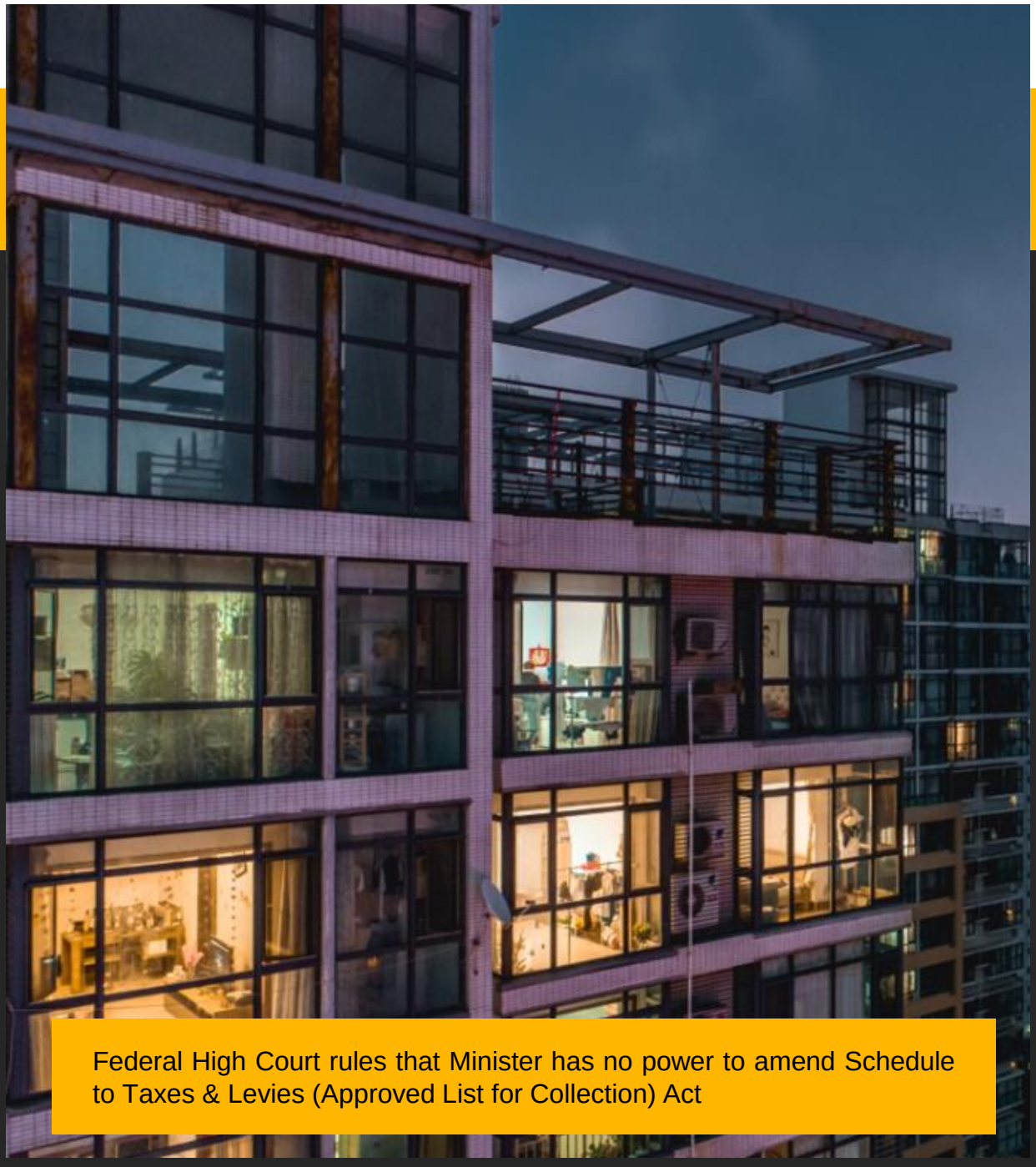
Analysis and takeaway

The ruling is an indication of the Tribunal's policy to, as much as possible, allow taxpayers exercise their right to challenge decisions of the tax authorities thereby guaranteeing taxpayer's access to justice. The ruling is consistent with the earlier decision of the Tribunal in ***United Capital v. FIRS*** where the Tribunal held that payment under protest of an assessed tax liability does not rob the taxpayer of the *locus standi* to challenge the same assessment. Additionally, the ruling is indicative of the fact that administrators could be held accountable for statements made in their official capacity.

Parties intending to challenge actions, decisions or proposed actions of tax authorities must still demonstrate a sufficient interest and what impending or actual injury suffered by such decisions or proposed actions.

The Registered Trustees of Hotel Owners and Managers Association of Lagos v. Attorney General of the Federation and Minister of Finance

FHC/L/CS/1082/19



Federal High Court rules that Minister has no power to amend Schedule to Taxes & Levies (Approved List for Collection) Act

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Background

The Taxes and Levies (Approved List for collection) Act [the Act] was enacted to allocate power to collect taxes and levies among the different tiers of Government. The Schedule to the Act lists out the taxes to be collected by each tier.

S. 1(2) of the Act provides that the Minister of Finance may, on the advice of the Joint Tax Board [JTB] and by Order in the Gazette amend the Schedule.

Based on this provision, the Minister on the advice of the JTB published the Schedule to the Taxes and Levies (Approved List for Collection) Act (Amendment) Order 2015 [Amendment Order] published in the official gazette. The amendment introduced the Hotel Occupancy and Restaurant Consumption tax as a tax that may be collected by the States.

Questions for determination

The Registered Trustees of Hotel Owners and Managers Association of Lagos (Plaintiff) filed a suit at the Federal High Court, Lagos division challenging the Minister's act of amending the Schedule. The questions before the court can be summarized as follows;

1. Whether by virtue of Section 4 of the 1999 Constitution, the legislative powers of the Federal Republic are vested in the National Assembly?
2. Whether the Minister of Finance has constitutional powers to amend an Act of the National Assembly?
3. Whether the provision of S.1(2) of the Act is inconsistent with the provisions of the 1999 Constitution and therefore null and void?
4. Whether the Amendment of the schedule to the Act by the Minister is inconsistent with the provisions of the 1999 Constitution and therefore null and void?

Parties' arguments

The Plaintiff argued that;

- the Schedule to an Act is a part of the Act and therefore any amendment to the schedule is an amendment of the Act.
- the Legislature may lawfully delegate its power to make laws to any person, but such subsidiary legislation must remain within the control of the Legislature and the Legislature cannot abdicate its constitutional duty to make laws

In response, the Defendants argued that

- the plaintiff has no right to institute the case on the basis that their civil rights and obligations were not in issue.
- the action of the Minister is an administrative step aimed at carrying out the intentions of the Legislature and not a usurpation of the Legislature's duties.
- The Minister can modify an existing law under S.315 of the Constitution.

The decision

The Court held that the Plaintiff is entitled to challenge the amendment to the Schedule since the amendment ultimately affects the business of its members. The FHC held that a Schedule to an Act cannot be delegated legislation since it is part of the Act and has the same force as the Act itself.

Therefore any act that affects the wording of the Schedule is an amendment of the Schedule, which is an exercise of legislative powers. The Court therefore held that the amendment of the Schedule by the Minister as unconstitutional, null and void.

Analysis and takeaway

Nigeria's Constitution recognises the doctrine of separation of powers which guarantees the distinction of powers between the three arms of government (executive, legislature and judiciary) – each arm is precluded from exercising powers ascribed to other arms. The doctrine admits certain exceptions and encourages a system of checks and balances.[1]

The ruling puts a focus on similar powers of the Minister contained in several other tax laws such as:

- section 19 of the Personal Income Tax Act (PITA) which grants the Minster power to vary the class of persons listed in the 3rd Schedule and thereby exempt the income of those persons from tax, in pursuance of a treaty or arrangement involving the federal government.

- section 38 of the Value Added Tax Act (VATA) which grants the Minister power to, by Order, amend the VAT rates and vary the list of exempt goods and services provided in its 1st Schedule.

- sections 24 and 63 of the Petroleum Profits Tax Act (PPTA) which grants the Minister power to make rules that modify the Act in order to ascertain profits and tax due on companies that participate in joint ventures/partnerships as well as and power to amend the 1st Schedule to the Act.

- section 25(6) of the Companies Income Tax Act (CITA) grants the Minister the power to amend the 5th Schedule which provides a list of eligible funds and institutions that can receive tax deductible donations in Nigeria. The FIRS has exercised this power by Regulation.

The ruling raises a concern that such powers may be challenged on constitutional grounds. The Minister may have to review the exercise of these powers to identify and remediate any constitutional breaches. Going forward, it is also expedient for the legislature to be mindful of the powers "donated" to the executive arm so as not to breach constitutional provisions.

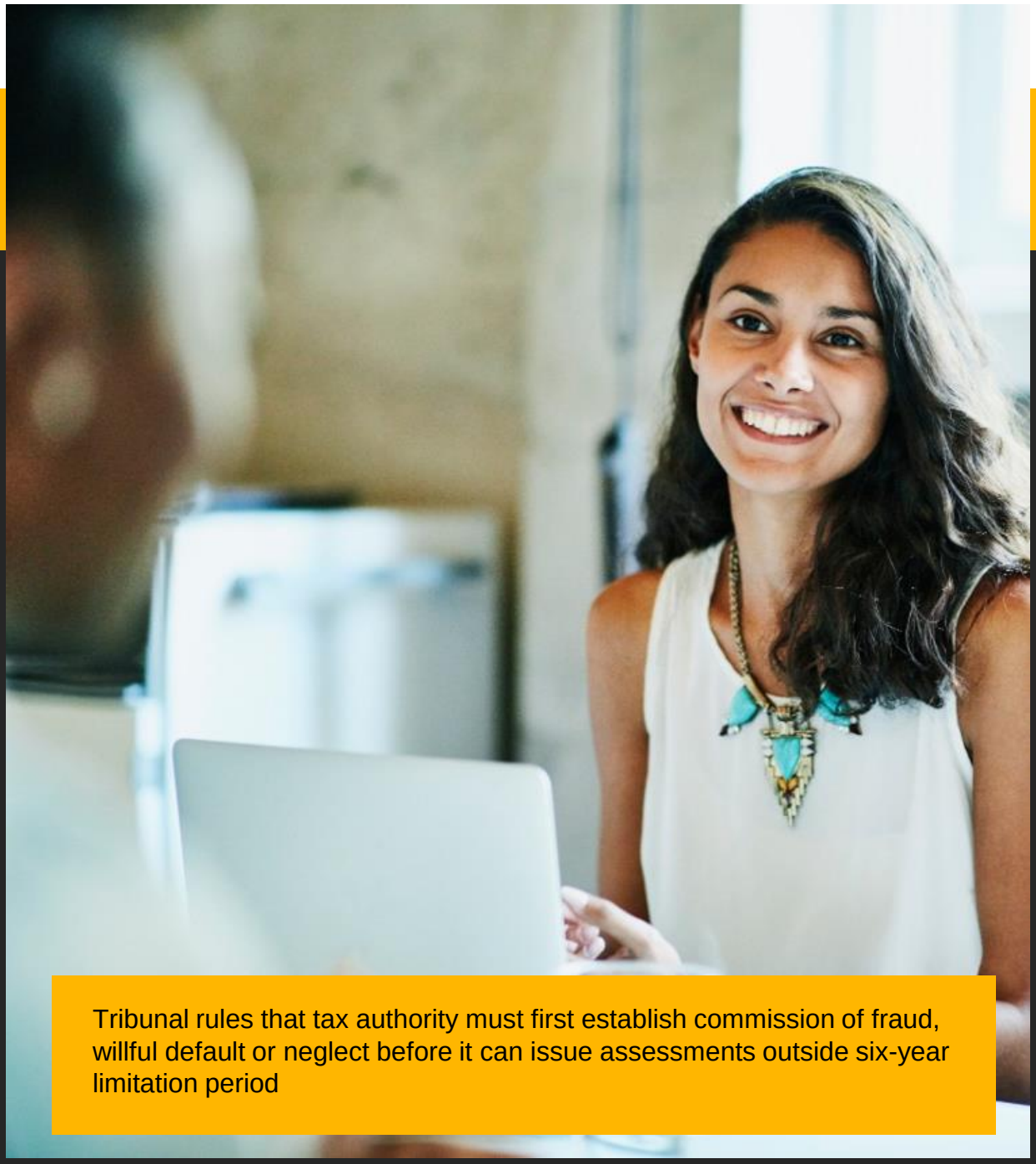
While it is unlikely that the tax authority will challenge the reliefs granted to taxpayers by virtue of a delegated power exercised by the Minister, taxpayers who are currently enjoying such benefits or incentives brought about by Orders made pursuant to the highlighted sections may wish to consider available options to ensure that they do not suffer losses in the event of a challenge, these include advocating for an amendment by the Legislature.

Finally, it is noteworthy to draw a distinction between the powers discussed above and powers to make delegated legislation. The Minister as a member of the executive arm of government has powers to make subsidiary legislation provided the legislation is consistent with and within the confines of an enabling Act of the legislature.

1. for purposes of checks and balances e.g. the requirement for executive assent to legislative bills, legislative ratification of treaties entered into by the executive and executive budgets etc, for oversight purposes e.g. supervisory jurisdiction of the courts over legislative and executive powers, or out of necessity e.g. subsidiary/delegated legislation

Citibank v. FIRS

TAT/SSZ/017/2018



Tribunal rules that tax authority must first establish commission of fraud, willful default or neglect before it can issue assessments outside six-year limitation period

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Background

Section 55 of the Personal Income Tax Act (PITA) sets a six-year limitation period within which a tax authority must assess a taxpayer to additional assessments. However, section 55(2) provides an exception to the limitation period – where the taxpayer has committed fraud, willful default or neglect the tax authority can assess the taxpayer outside the six-year period and as many times as possible.

Facts

In *Citibank Nigeria Limited vs Rivers State Board of Internal Revenue,* the tax authority raised additional assessments against the bank covering a period of 19 years. The bank objected and subsequently appealed on the basis that the assessments were unlawful given that the tax authority had not proved fraud, willful default and/or neglect.

Taxpayer's arguments

The taxpayer's arguments are summarised in the following paragraphs:

a) the tax authority failed to prove or establish fraud, willful default or neglect
b) section 332 of the Companies and Allied Matters Act (CAMA) do not require records to be kept longer than six years as such it did not provide the documents in respect of those years
c) the demand notice was premature given that it had, with respect to the assessments within the six-year period, provided relevant documents to a Special Tax Audit Reconciliation Committee (STARC) and had requested for meetings to resolve the audit.

Tax authority's arguments

a) Section 55(2) does not put a burden on tax authorities to establish the guilt of a taxpayer but only required a tax authority to show that any of fraud, willful default or neglect had been committed by the taxpayer.
b) The bank's objection was not valid in law.

The decision

The Tribunal found as a fact that the tax authority did not establish the existence of fraud, willful default and/or neglect before the demand notice and during trial. Following which the Tribunal held that:

- the assessments relating to the years outside the limitation period were unlawful
- the bank's objection was valid in law as it met the requirements of the law – it was in writing, contained the grounds of objection and was filed within 30 days of the demand notice,
- with respect to the assessments with the six-year period, the tax authority was too hasty and it "didn't properly exhibit its duty of fairness and due diligence in carrying out its statutory responsibility" especially since it could have exhausted the opportunities for settlement offered by the STARC meetings.

Analysis and takeaway

The ruling sets a high bar for tax authorities as they are required to establish taxpayer guilt or commission of fraud, willful default or neglect before they can issue assessments outside a six-year period. Therefore, authorities would have to, during trial, lead evidence of the existence of any of these exceptions. In addition, where fraud is alleged, a tax authority would need to plead the details of fraud specifically in its Reply as required by civil procedure rules. One point, however, requires some clarification – given that, by its enabling law[2], the Tribunal does not have jurisdiction over criminal matters as it "shall be obliged pass" information / any evidence of criminality to the relevant authorities, it appears that fraud in section 55(2) may not be "criminal fraud" since, by law, the Tribunal cannot entertain criminal matters. Rather section 55(2) would refer to "civil fraud" as defined by the same Tribunal in *Delta Afrik Engineering Nig v. Akwa Ibom State Board of Internal Revenue.*[3] In this appeal, the Tribunal, relying on the Black's Law Dictionary, 9th Edition defined "fraud" as:

A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment. Fraud is usually a tort, but in some cases (especially when the conduct is willful) it may be a crime.

All other definitions relied on in the *Delta Afrik* case suggest that fraud is a civil offence. Given the definitions, all that the tax authority needs to establish is that a taxpayer "knowingly misrepresented the truth or concealed a material fact with the intention to induce the tax authority to act to the tax authority's detriment". Therefore, taxpayers would need to take extra care to be sure that all information communicated to tax authorities is correct and true.

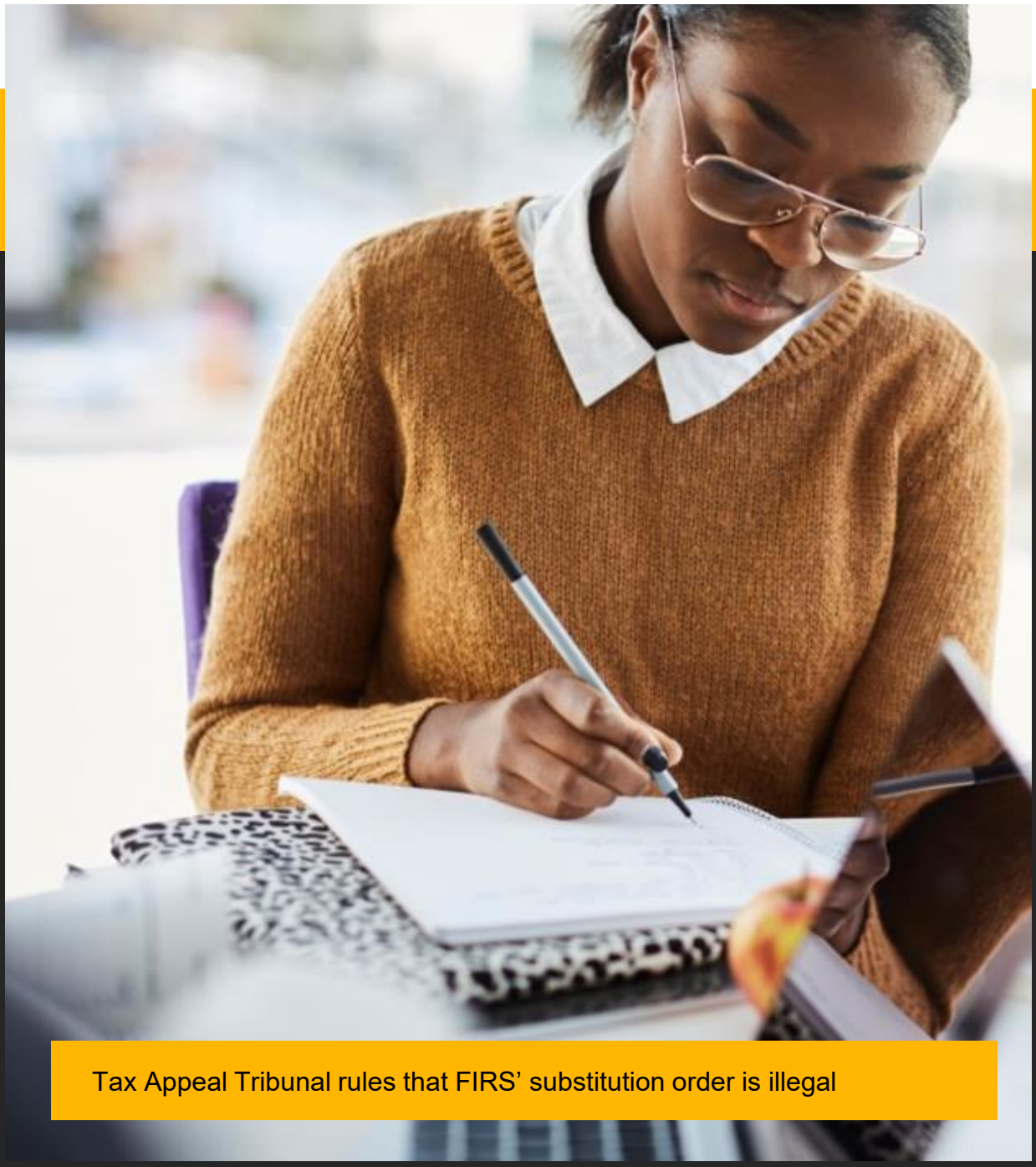
However, to avoid all these rules, tax authorities need to conclude audits and issue assessments within the six-year period.

2. See paragraph 12 of the 5th Schedule to the Federal Inland Revenue Service (Establishment) Act 2007

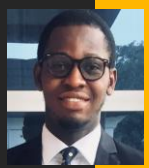
3. TAT/SSZ/001/2017, delivered on 20th January 2020. In this appeal, the Tribunal, relying on the Black's Law Dictionary, 9th Edition

Michael Oluwole Oladotun (Liquidator, Nu Metro Retail Nigeria Ltd.) v. Executive Chairman, FIRS

TAT/LZWHT/020/2019



Tax Appeal Tribunal rules that FIRS' substitution order is illegal



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Background

Sections 49 and 32 of the Companies Income Tax Act and Federal Inland Revenue Service (Establishment) Act respectively give FIRS powers to appoint an agent on behalf of a taxpayer for the purpose of collecting any tax payable to FIRS. To be valid, the appointment must meet the following cumulative criteria:

- must be in writing,
- the tax has or will become payable and
- the agent must have in his custody funds belonging to the taxpayer.

To increase tax collection, FIRS appointed banks as agents of taxpayers (usually referred to as Substitution Orders). In addition to the appointment, FIRS ordered banks to freeze or put a lien on the account of alleged tax defaulters. In most instances the banks complied but many taxpayers complained that FIRS abused its powers of appointment.

Facts of the Case

In *Oladotun v. Executive Chairman, FIRS*, the FIRS instructed the taxpayer's bank to put a lien on the taxpayer's accounts with the intention of recovering the taxpayer's alleged tax debt. The bank complied without recourse to the taxpayer who was in the process of a Creditors Voluntary Winding Up. The taxpayer sued.

Taxpayer's argument

The taxpayer raised a number of arguments relating to the validity of the appeal, however, the crux of the taxpayer's case was that FIRS' appointment of the bank as the taxpayer's agent was wrong in law because FIRS did not fulfil the conditions precedent before appointing the bank. Specifically, FIRS did not issue any notice of assessment on the taxpayer therefore no tax could have been payable to FIRS.

The taxpayer also argued that by failing to give it the opportunity to defend itself, its constitutional right to fair hearing was infringed.

FIRS' argument

FIRS did not have any valid arguments because the Tribunal barred FIRS for failing to file its Reply to the appeal despite multiple orders of the Tribunal to do so and failing to pay costs awarded to the taxpayer on account of FIRS' consistent failure to file its Reply.

The decision

The Tribunal held that:

- FIRS did not meet all the conjunctive conditions precedent to the power of appointment,
- the taxpayer was not given the opportunity of being heard either by FIRS or the bank before a lien was placed on its account,
- relying on a previous decision of the Federal High Court[4], placing a lien on the taxpayer's account without a court order and without establishing tax fraud or evasion was unlawful and
- it had no powers to award damages in favour of the taxpayer.

Analysis and takeaway

The decision further clarifies and limits the extent of FIRS' power of appointment. Where all conditions are not met, taxpayers can successfully challenge a Substitution Order. In addition, FIRS does not have the powers to order banks to freeze accounts in the absence of a court order. Such orders are also restricted to instances where tax fraud or evasion has been established.

The decision has far reaching implications as it will be binding on all tax authorities across the 36 states in Nigeria including the Federal Capital Territory. Tax authorities may also be exposed to litigation before the High Courts for damages. Taxpayers may decide to file actions before the Tribunal to challenge any abuse of the powers and the High Courts for damages. Tax authorities may also be liable for procuring breach of the banker / customer contract especially if it is established that FIRS abused its power of appointment.

It is interesting to note that both sections 49 and 32 give the agents the right to object against such appointment. However, the provisions do not give any guidance on the grounds of objection.

Reasonable grounds of objection by the agents could be:

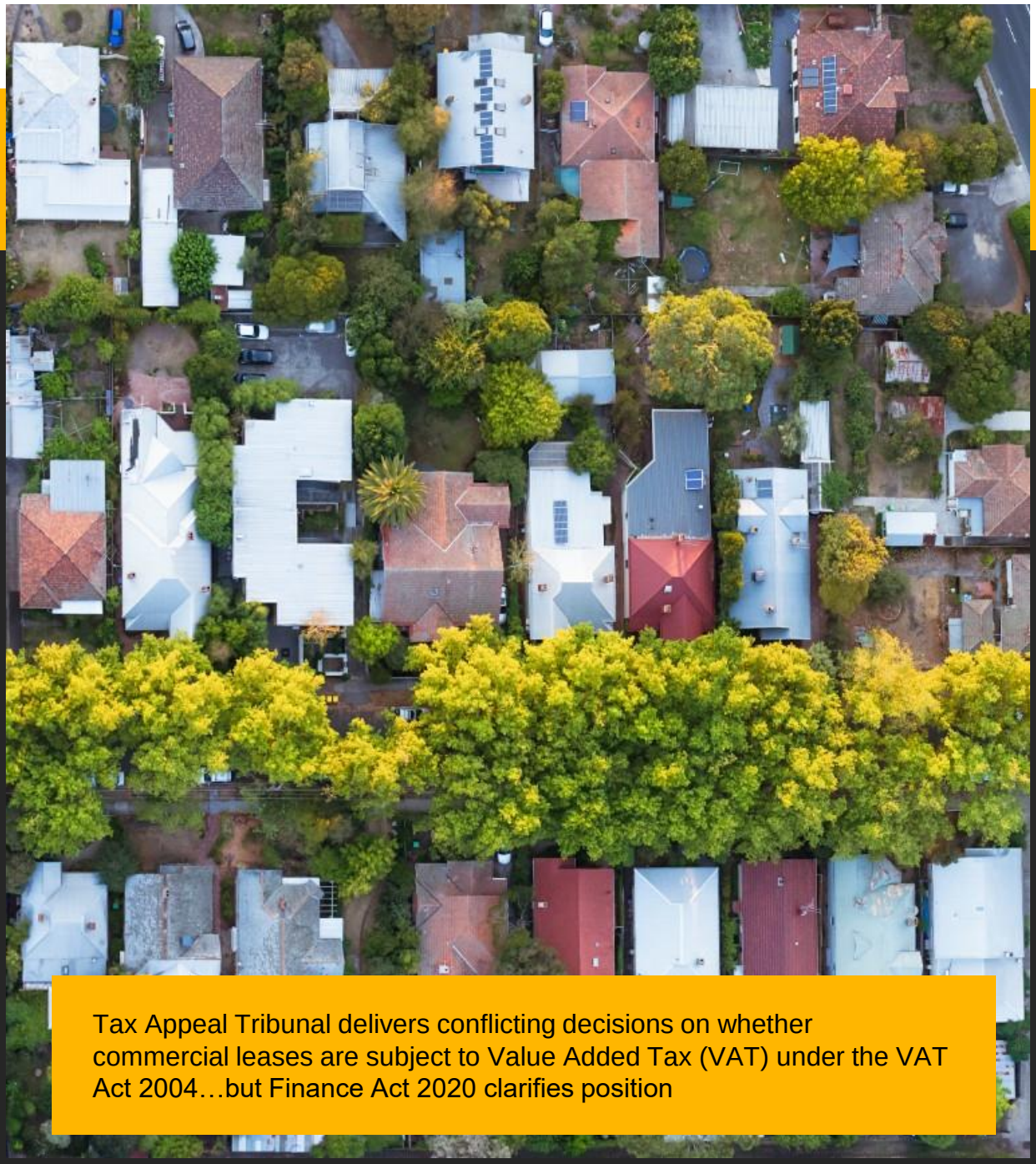
- failure by FIRS to provide proof that the tax has or will become payable,
- the existence of a lien over the account sought to be frozen,
- FIRS carrying out acts ultra vires or abuse of its power.

Therefore, to protect themselves from damages, banks and other agents must examine any contractual or fiduciary duties owed to the taxpayer before accepting the agency appointment.

4. Ama Etuwewe Esq v. FIRS & Anor (Suit No. FHC/WR/CS/17/2019)

Chief J.W. Ellah & Sons Company Ltd v. FIRS & Essay Holdings Ltd v. FIRS

TAT/SSZ/001/2019
TAT/LZ/VAT/029/2019



Tax Appeal Tribunal delivers conflicting decisions on whether commercial leases are subject to Value Added Tax (VAT) under the VAT Act 2004…but Finance Act 2020 clarifies position

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Background

According to the VAT Act, 2004 [Act], VAT is imposed on goods and services but "goods" and "services" were not defined under that Act. The First Schedule to the Act contains a list of exempt goods and services. "Lease" is not included on either list.
To clarify certain provisions of the Act particularly relating to exemptions, FIRS issued Information Circular 9701 in 1997. While the Circular exempted residential accommodation from VAT, commercial leases was not exempted.

Facts of the appeal

In *Chief J.W. Ellah & Sons Company Ltd v FIRS* and *Essay Holdings Ltd v. FIRS* decided by the Tax Appeal Tribunal (TAT) in Benin and Lagos Zones respectfully, the TAT delivered conflicting decisions on whether commercial leases are subject to VAT. Both zones also adopted different approaches to the role of Information Circulars in interpreting statute.
The appeals were contested under the VAT Act, 2004.

The appeals

The facts of both appeals are similar. In both appeals, the FIRS assessed the taxpayers to VAT which, according to FIRS, should have been collected by the taxpayers and remitted to FIRS on rents received on commercial leases.

FIRS' position is that commercial leases are not contained as an exempt item in the First Schedule to the VAT Act. In addition, commercial leases / accommodation are not exempt under Information Circular 9701.

The taxpayers' views were that leases are neither goods nor services so should not be subject to VAT. In Essay, the taxpayer argued that leases are an incorporeal right and do not amount to goods or services. The taxpayer relied on CNOOC v AGF where the Federal High Court decided that an interest in an oil mining lease was not subject to VAT.

The decisions

In *Ellah*, delivered 9 September 2020, the TAT held that commercial leases were subject to VAT. In arriving at its decision, the TAT relied on the definition of "Supply of Goods" in the VAT Act particularly on the phrase the letting out of taxable goods on hire or leasing. The TAT also relied on the Information Circular 9701 holding that it would be inconsistent of the taxpayer to accept the exemption on residential accommodation under the Circular but not accept that commercial leases were not exempt.

However, in *Ess-ay* delivered a day after, the TAT held that leases are not goods. They are incorporeal rights which are not subject to VAT. In arriving at its decision, the TAT relied on the definition of goods in the UK Sales of Goods Acts and Lagos State Sales of Goods Law that goods are severable from land. The TAT also relied on the decisions in *CNOOC v. AGF*[5] and *Momotato v UACN*[6] to hold that interest in land were neither goods nor services.

In *Ess-ay*, the TAT also pronounced on the effect of Information Circular 9701. The TAT held that the Circular does not amount to subsidiary legislation so it cannot amend the VAT Act.

However, such circulars are useful tools for determining the mind of tax authorities which help taxpayers plan their affairs.

Analysis and takeaway

It does not help that the TAT gave conflicting decisions. However, since the TAT is not bound by the decisions of another Zone, parties can rely on a decision that supports their positions or seek resolution from a higher court. Alternatively, it could be said that the decision in Ess-ay, coming after the Ellah case should take precedent being the later in time and on the basis that the Tribunal in Lagos must have considered the judgement yet chose to depart from it.

The decisions also raise the question of refunds. Can taxpayers rely on *Ess-ay* to apply for refunds? The answer to this question would depend on another question – whether the law pre-FA 2019 has always been that commercial leases were not subject to VAT or whether the decision in *Ess-ay* only just determined the position of the law. In the former, taxpayers would have a right to request for refunds of VAT previously paid.

To remove the uncertainties under the Act, "goods" and "services" were defined under the Finance Act 2019 (FA 2019). From the definitions, it appeared that interests in land were outside the scope of VAT. The definition of "goods" in FA 2019 includes:

"any intangible product, asset, or property over which a person has ownership rights, or from which he derives benefits, and which can be transferred from one person to another excluding interest in land"

On the other hand, "services" were defined as:

"anything other than goods, money or securities which is supplied excluding services provided under a contract of employment"

Though the popular view was that "interests in land" (which includes leases) are a specie of exempt goods and because they do not fall under the definition of "services" they are exempt from VAT, some commentators argued that the phrase "anything other than goods" in the definition of "services" could be interpreted to mean that interests in land falls under services and therefore subject to VAT. To put the uncertainty to rest the FA 2020 further clarified the definition of "goods" and "services". While the new definition of "goods" excludes "land and building", "services" also exclude "interest in land and building". With the new definitions, land and all interest in land are outside the scope of VAT.

Another interesting point to note in *Ess-ay* is the extent of Ministerial power to amend laws. In *Ess-ay*, the TAT relying on the decision in *HOMAL v. FIRS*[7] raised the question of the validity of Ministerial power in section 38 of the VAT Act to amend the VAT Act. Given that such powers are inconsistent with Nigeria's Constitution, they may be declared null and void in subsequent cases. Therefore, relevant government authorities exercising such powers should take care to determine that such powers are consistent with the Constitution.

5. 2011 4 TRLN 186
6. 6 All NTC 37
7. See page 11 above

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Notes

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