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A fresh perspective to the VAT controversy on basic food items

Knowing what a basic food item is, should be “basic” knowledge... probably something that kids learn in school. However, some complications set in when you are trying to apply the Value Added Tax (VAT) exemption to such items. That is when basic becomes not so basic anymore, at least, from the taxman’s perspective.

The controversy before the Finance Act

Basic food items are listed as VAT exempt in the VAT Act. However, the Act did not provide a definition of what constitutes basic food items. This has resulted in uncertainty and disputes. In particular, the Federal Inland Revenue Service (FIRS) took the following position in line with its Information Circulars of 1997 and 2009:

For something to qualify as basic food, it must be:

- a) A staple food item, and
- b) Unprocessed.

In addition to this, the FIRS introduced additional conditions in practice by suggesting that food items will not qualify as basic food items if:

- a) They are packaged, and/or
- b) They are perceived as ‘luxury’ (from the FIRS’ perspective) as in the case of bottled water, considered below.

This inconsistency by the FIRS created a lot of confusion for taxpayers. For example, the FIRS would classify the simple and affordable “Agege” bread consumed by low-income earners as a basic food, but classify sliced bread as non-basic. Similarly, the FIRS was known to consider bottled water as a luxury that should be subject to VAT, but “pure water” sold in small sachets as VAT exempt. These subjective approaches were not imposed by the law. Basic is basic, even if consumed by rich as well as the poor.

On processing, a number of questions were raised by taxpayers but there was no consistency in response from the FIRS. Some examples include:

- what is the threshold of processing that changes a food item from basic to non-basic?
- Can raw food produce, that are not edible in their natural state (e.g. cassava roots), be considered food (and by extension, a basic food item)?
- Does processing mean any form of value addition to the staple food or does it entail any activity that goes into transforming the staple food into edible form?
- Will washing, peeling, drying, grinding, cooking or cutting these raw items constitute processing?

Interpretation of the courts

The courts also found it difficult to set a clear ‘bright line’ definition which demonstrated the difficulty in defining the term. There are two precedents where the FIRS’ position was challenged but with conflicting outcomes at the court. These suits involved:

- 1) Monamer Khod Enterprise Nigeria Limited; and
- 2) Some bottlers who were members of the Association of Food, Beverage and Tobacco Employers (AFBTE).

In the Monamer case, the Court ruled in favour of the FIRS, and held that taxable goods include all goods manufactured in Nigeria, including water once it has undergone some processing and packaging. While in the AFBTE case, the Court held that water is basic to life and being a basic food item, was not a luxury good and therefore not liable to VAT. In the words of the Judge, once an item is exempted, its packaging, processing or reproduction does not derogate from the fact that the item is exempted.

Some new issues to watch out for under the Finance Act, 2019 and the VAT Modification Order, 2020

The Finance Act, 2019 and the recently issued VAT Modification Order, 2020, both define basic food items as agro and aqua based staple food described as:

- a) Additives and Bread (Brown and white);
- b) Cereals including maize, rice, wheat, millet, barley, sorghum etc.;
- c) Cooking oils and Culinary herbs;
- d) Fish of all kinds;
- e) Flour and Starch;
- f) Live or raw Meat and Poultry products including eggs;
- g) Milk (fresh, liquid and powdered);
- h) Nuts, Fruits, Pulses and Vegetables of various kinds;
- i) Roots such as yam, cocoyam, sweet and Irish potatoes;
- j) Salt and herbs of various kinds; and
- k) Water (natural and table water).

The VAT Modification Order also breaks down each listed food category into their respective HS codes. This eliminates some of the controversies from the past, although some new issues are raised:

- 1) **Lack of input VAT claim:** Ordinarily, players in the distribution chain should be able to reclaim the VAT they pay when purchasing items (input VAT). However, the Nigerian VAT Act only allows the reclaim of input VAT, where the items purchased are resold with VAT, or directly used to produce other goods also sold with VAT.

Agro-manufacturers that produce or package basic food items may incur VAT on certain purchases such as packaging and processing materials, etc. Based on the VAT Act, these producers cannot reclaim the input VAT incurred, because their sales - basic food items, are VAT exempt.

The producer then has to try to bear some of the VAT cost resulting in reduced margins, or to include cost in the pricing of the item. This means that the products which are supposed to be VAT exempt may ultimately carry an element of VAT in their selling price, partially defeating Government’s objective to make such items more affordable.

- 2) **Whether agro-traders should self-charge for VAT on purchase of basic food items:** The Finance Act includes a provision which requires businesses to self-charge and remit VAT on transactions where the suppliers don’t charge VAT. At first glance, this can mean that the agro-trader who purchases VAT-exempt products for resale, would be required to self-account for the VAT. However, it is obvious that a purchaser of a non-taxable item should not self-charge VAT. Although the FIRS has not provided any clarification on this, we expect that they would apply the law in this way to give effect to the tax exemption.

- 3) **Omitted items:** Definitions are good, as they bring about clarity. However, depending on how detailed or summarised, they may lead to exclusion of some items. A typical example will be the case of “Soya” milk. The Finance Act clearly exempts milk from VAT. It also exempts legumes and cooking oils. However, Soya milk which is a very popular food product in Nigeria, may have inadvertently been omitted.

This is because Soya milk is technically not milk (which is defined as sourced from animals), and may also no longer be considered a legume (since it has been crushed and refined). It is also not a cooking oil. This shows that several food items that may be intended for the VAT exemption, may have been omitted through the definitions in the Finance Act.

Another example is freshly squeezed fruit juices where through squeezing (without further processing as in the case of juice manufacturing) the item loses its tax-exemption status. A case could also be made for “Zobo”.

- 4) **Some developments to watch out for:** A review of the breakdown of the exempt food items show that they are only exempt in certain states e.g. raw, “semi-processed” or “unprocessed” without a clear definition of what this means.

Post-Finance Act, the FIRS made some posts via its official Instagram handle, such as: *“Basic unprocessed food items like yam...rice...cassava, as it is in the hand of the farmer, you do not pay tax on them. But when you buy and process them, you add value to them. Once value is added, VAT is charged.”* Also, *“the moment you add value to certain goods that are statutorily exempted, they become taxable.”*

This may be the case, so long as significant value has been added such that the product clearly no longer fits into the category of exempt items. For example, butter and cheese which are both made from milk. Milk is VAT exempt, but butter and cheese are not. However, an issue may arise when considering items such as raw yam or raw potato chips that have been packaged and frozen for sale. These ordinarily should remain exempt, even though they are not in the same form as when obtained from the farm.

Conclusion

The Finance Act, 2019, provides significant clarity to the uncertainty around basic food items, by defining and listing exempt items. While this list is a right step, it may not be exhaustive enough to cover all food items that are basic or which benefit the poor e.g. Soya milk and Zobo. There is also a need to monitor how the FIRS would apply the rules in practice on some items e.g. freshly squeezed juices and packaged raw chips.

We also recommend in the future that food items should be zero-rated instead of VAT exempt to allow producers to claim credits for any VAT paid on inputs/raw materials, reduce cost of the food items for final consumers, and achieve the government’s overall objectives.

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