FINANCE ACT, 2019:

WHAT VAT?

Proem

The President of the Federal Republic of Nigeria, on Monday January 13, 2020, signed into law the much-talked about Finance Bill, 2019 which was submitted to the National Assembly alongside the year 2020 budget proposals. It is the first time since Nigeria's return to democratic rule, in the year 1999, that a fiscal Bill will accompany the Appropriation Bill for enactment by the National Assembly. The Finance Act is a representation of an attempt by the federal government to utilise a budgetary tool to moderate the fiscal environment and stimulate the business economy through tax reforms. With over 90 (ninety) changes to the extant tax laws, the Finance Act introduces sweeping changes, perhaps the most impactful revision of our tax laws in one fell swoop since independence of Nigeria. Some of the significant amendments effected by the Finance Act include: the exemption of companies with an annual turnover of N25 million and below from companies income tax compliance; extension of foreign companies taxable in Nigeria to include digital companies with "significant economic presence" in Nigeria; imposition of excise on certain imported goods; introduction of bonuses for early tax remittances of companies income tax; introduction of withholding tax application to dividends distributed from petroleum profits; stamp duty on bank transfers are only applicable to transfers of N10,000 and above amongst others. In this article, we undertake a review of the changes made to the VAT ("Value Added Tax") regime highlighting its underlying issues and legal implication of these changes on the rights of the taxpayer in Nigeria's VAT system.

VAT in Nigeria: What It Was

VAT was introduced in Nigeria, through Decree 102 of 1993[1] (now codified as Value Added Tax Act Cap. V1 Laws of the Federation 2004 ("VATA")).

Introduced by the military regime of General Ibrahim Babangida, VAT was billed to replace the Sales Tax Decree 7 of 1987 as administered by the then component states of Nigeria and represented a planned shift from income tax to consumption tax as a means of revenue generation in the wake of dwindling oil prices, at the time.

According to the VATA, VAT is charged on the value[2] of all goods and services[3] supplied in Nigeria, save for the items listed in the First Schedule of the VATA[4]. Being an invoice based consumption tax borne by the consumer of the taxable goods and services, the supplier of the taxable goods and services is mandated to charge VAT at a rate of 5% on the consideration payable by the consumer and remit same to the relevant tax authority, in this case – the Federal Inland Revenue Service ("FIRS"). Where, however, the purchaser is not an end consumer of the goods and services, the VAT paid to the supplier is an "input tax" which is a cost to his business and the purchaser is empowered, by law, to charge VAT ("output tax") on all direct costs related to the resale or manufacturing of the taxable items. The purchaser is mandated to render a monthly return of all goods and services purchased or supplied by him in the preceding month and where the output tax exceeds the input tax, remit the excess to the FIRS; or if the input tax exceeds the output tax, be entitled to a refund of the excess tax from the FIRS.

The previous VAT regime was not without its challenges. Several litigious proceedings have been founded on contentions which arose from its administration in Nigeria. Some of the contentious issues include the formula adopted sharing the revenue derived from VAT; constitutional issues arising from the enactment of sales tax by some states; VAT-ability of imported services in Nigeria; application of VAT to intangible goods and basic food items etc.

1 *For administrative convenience however, the Decree became effective in January, 1994.*

2 *Prior to the Finance (Miscellaneous Taxation Provisions) Decree 31 of 1996, VAT was levied on all goods and services in Nigeria rather on the value of the goods and services.*

3 *Section 46 of the VATA defines "supply of services" to mean any service provided for a consideration. Additionally, "supply of goods" is defined to include the sale and delivery of taxable goods and services.*

4 *Parts I, II and III of the First Schedule of the VATA set out the items which are exempt from the scope of VAT in Nigeria. These include basic food items; educational and medical products; agricultural materials, all exports, services rendered by community, mortgage and people's banks; plants and machinery purchased for gas utilisation in the downstream petroleum industry etc. These items have been expanded in the Finance Act as we shall analyse below.*

5 The commencement date for the Finance Act is February 1, 2020.

6 See FBIR v. Ibile Holdings (2010) 2TLRN 151; Momotato v. UACN Property Development Company Plc (Unreported) FHC/L/CS/1016/05.

7 [2013] 1. NRLR 88

8 FIRS v Gazprom Oil & Gas Limited FHC/ABJ/TA/1/2015;

9 (2019) LPELR-47865(CA)

The Finance Act: New VAT Realities

Giving the foregoing context, we set out below our discourse on legal and practical considerations which arise from the amendments made to the VAT regime in Nigeria by the Finance Act:

A. The Finance Act stipulates an increase in VAT rates by 50% i.e. VAT at a rate of 7.5% shall be applicable to the supply of all non-exempt goods and services in Nigeria.[5] This increase is in tandem with the National Tax Policy, 2017 (the "NTP"), which stipulates that one of the guiding principles of the Nigeria tax system shall be a shift in focus from a reliance on income taxes to indirect taxes, which are easier to collect and administer, as a stimulus for optimum revenue generation and to reduce incidences of tax avoidance. At 4.7% as at Q1, 2019, Nigeria's tax to Gross Domestic Product ("GDP") ratio is one of the lowest in the world. The increase in VAT is a move by government to shore up its revenues which have hitherto taken a hit due to slow economic growth. The slow economic growth was occasioned by a slump in oil prices and a dearth of investments in the oil and gas industry, occasioned by legislative uncertainties owing to a number of issues, including the delayed passage of the Petroleum Industry Bill (the "PIB"). The changing VAT regime is also part of the ongoing efforts to effectively diversify Nigeria's revenue drive from an almost total reliance on proceeds of crude oil sales. This is not the first attempt to increase VAT rates in Nigeria since the introduction of the tax in 1994. The attempt by former President Olusegun Obasanjo in the twilight of his administration to increase the VAT rate by 100% was fiercely resisted by the civil society and reversed to status quo by his successor, President Umaru Musa Yar'adua. Quite fortunately, the government of the day adopted an approach of consultation with relevant stakeholders as well as constant media representations which appears to have placated the general populace. However, being that VAT is a tax borne by the final consumer, it may well be expected that a rise in the tax rate will translate into an increase in commodity prices. Considering the present financial state of the average consumer in a slow economy recovering from recent recession, a price hike may not be met with smiles and good cheer. In addition to the palliatives offered to SMEs, which we discuss in subsequent paragraphs, it behoves on government to restore the confidence of the people by utilising the increased revenue generated from VAT to embark on critical infrastructure and capital expenditure projects.

B. The VATA was devoid of a definition for goods or services. As a result of the absence of a definition of goods and services in the VATA, tax adjudicatory fora in Nigeria had in a number of judicial decisions established that transactions in respect of incorporeal property or choses in action, which did not by their nature constitute a transaction in goods or services, were excluded from the tax net of VAT.[6] A case in point is the CNOOC Exploration and Production Nigeria Limited & South Atlantic Petroleum Limited v. Attorney General of the Federation & 2 Others (the "CNOOC Case").[7] In the CNOOC Case, Sapetro assigned 90% of its PSC contractor rights and interest in OML 130 to CNOOC. The FIRS, pursuant to a tax audit, sought to levy VAT on the transaction. The action was brought before the Federal High Court (the "FHC") to determine whether VAT is applicable to a transfer of incorporeal property in Nigeria. In its reasoning, the FHC held, in complete agreement with the submissions of the plaintiff, that the transaction was not subject to VAT because the contractor rights in the PSC arrangement do not constitute either goods or services as contemplated by the VAT Act.

The Finance Act introduces a definition of goods to include "any tangible product, asset or property over which a person has ownership or rights or from which the person derives benefits and which can be transferred from one person to another". Similarly, services are defined as "anything other than goods, money or securities which is supplied excluding services provided under a contract of employment". This codification of a definition for "goods" lays to rest controversies around the applicability of VAT to property transactions involving intangible rights and firmly encapsulates in the tax net of the FIRS, all forms of transactions involving goods and services save as is exempted under the Finance Act.

C. The extant provisions of the VATA stipulated that a non-resident company ("NRC") that carries on business in Nigeria is mandated to register with the FIRS using the address of the recipient of the goods and services in Nigeria, and, similar to the obligation of Nigerian companies, include VAT on its invoices for remittance by the recipient of the goods and services in Nigeria in the currency of the transaction. Simple as it appears, the provisions of the VATA relating to the VAT-ablity of goods and services supplied by NRCs in Nigeria have been a subject of various disputes between taxpayers and the FIRS in Nigeria.[8] Ultimately, in Vodacom v. FIRS,[9] the Court of Appeal held that all services rendered by a foreign company to a company in Nigeria is subject to VAT in so far as the service is not exempted by the First Schedule to the VAT Act. The Court further stated that the duties to issue a VAT invoice and the duty to remit are not conjunctive; and that even where there is a failure to issue an invoice, the burden to remit VAT remains vested on the Nigerian company which has received a service; and it will be required to self-charge and remit VAT to the FIRS. This position of the Court of Appeal has now received legislative imparimatur through the Finance Act. The Finance Act makes the following enactments: services are deemed to be supplied in Nigeria if the services are provided in Nigeria, regardless of whether the services are rendered within or outside Nigeria; the recipient in Nigeria is mandated to, in respect of an invoice on which no VAT is charged, self-account for the VAT payable and remit the VAT to the FIRS. The present dispensation of the Finance Act, in accordance with its objectives, is in alignment with international best practices as espoused by the Organisation of Economic Cooperation and Development ("OECD")'s Destination Principle. The Destination Principle is applicable to international trade as an international norm and stipulates that VAT should be applicable on the goods and services at the place of consumption i.e. the total tax paid in relation to a supply is determined by the rules applicable in the jurisdiction of its consumption and therefore all revenue accrues to the jurisdiction where the supply to the final consumer occurs. This is in contrast with the origin principle according to which each jurisdiction would levy the VAT on the value created within its own borders.

D. The Finance Act codifies the exemption of all forms of water other than sparkling or flavoured water from the application of VAT. Part I of the First Schedule of the VAT Act enumerates nine (9) items, including basic food items, which the VATA classifies as goods exempt from VAT. In other words, VAT is not applicable to a transaction involving the supply of these items in Nigeria. However, the VAT Act fails to define basic food items, thereby leaving the meaning of basic foods open to various interpretations. The FIRS, in December 2009, released an Information Circular which defined basic food items to include sachet water other than bottled and packaged water. At the time, the FIRS argued that bottled and packaged water were luxury items and should be subject to VAT. In line with the FIRS' position, the FHC in Monamer Khod Enterprises Nig. Limited v. FIRS[10], held that packaged water is liable to VAT as a result of the processing and production process it undergoes which transforms it into a luxury good thus subject to VAT. However, that position changed when in the case of Warm Springs Waters Nigeria Limited & 8 Ors. v. FIRS[11], the FHC in 2015, departed from its earlier decision in the Monamer Khod case and held that water, in any form whatsoever, is a basic food item. The FHC further held that whether a product is vatable or not depends on whether it is exempted from VAT in the First Schedule of the VAT Act. Despite this subsisting decision of the FHC, the Finance Act still maintains an application of VAT to sparkling and flavoured water supposedly on the consideration that these forms of water are luxury goods. It is left to time to determine whether further judicial pronouncements will be sought in respect of this stipulation.

E. As a cushion for the effect of the impact of the increased VAT rate on small scale businesses and SMEs, the Finance Act introduces a number of palliatives which pertain to the operation of small enterprises in Nigeria. First, the Finance Act stipulates a threshold of N25, 000,000.00 for entities to comply with the requirements of compliance with the registration, charging and remittance obligations in respect to VAT. Therefore, from February 1, 2020, a person with an annual turnover of N25, 000,000.00 or less shall not be required to register for VAT, charge VAT on its invoices, render returns on its monthly sales and purchases or remit VAT to the FIRS. Second, the exempt list is expanded to include services rendered by microfinance banks; locally manufactured sanitary materials; and educational institutions at all levels.

Final Thoughts:

The amendments to the VAT regime in Nigeria made pursuant to the Finance Act are laudable. The government of the day is making reasonable attempt to diversify the revenue generation of the nation away from an over reliance on crude oil receipts to an introspection and focus on the manifold potential available in the indirect tax system. It has to be noted that the major provisions are an effort by the legislature through the law-making process to codify the judge-made clarifications in respect of the administration of VAT in Nigeria. However, the enactments in the Finance Act throw up a few practical considerations. For instance, the exemption of small companies (i.e. companies with a turnover of N25,000,000.00 or less) from the requirement to register with the FIRS for VAT purposes may open a window for potential tax evasion. Whereas the small company is unregistered, how does the FIRS take cognisance of its existence and monitor its progress to ensure that it is captured within the tax bracket as soon as it attains the relevant revenue threshold? Also, the Finance Act and the Provisional Clarifications on the Operationalisation of VAT Threshold, Self-Charging Principle & Companies Income Tax Rates in the Finance Act 2019 (the "Provisional Clarifications") stipulate that where a purchaser is issued an invoice on which no VAT is charged[12], the person shall self-charge the VAT payable and remit the applicable output tax to the FIRS. This requirement is rather impractical and not feasible to implement. It is not possible to see how every person who utilises the services of a professional services firm or purchases goods from a manufacturer with revenues below the threshold, would compute the applicable output VAT and remit same to the FIRS. Save for the mismatch in certain aspects of the Finance Act and practical realities, the purposes for which the Finance Act was enacted appear to be in the best interest of an efficient VAT system in Nigeria. However, and in the absence of articulate regulations or guidelines which clearly set out compliance mechanisms or necessary clarifications germane to an effective system, the hydra-headed controversies which characterised the erstwhile VAT framework may soon become a feature of the present regime.

10 Unreported, Suit No. FHC/S/SC/1/2004

11 Unreported, Suit No: FHC/L/CS/57/2015

12 Such instances include where the vendor is a small company with revenues below the N25million threshold.

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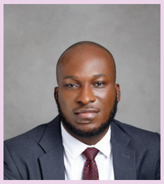

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