ESS-AY HOLDINGS LIMITED V. FEDERAL INLAND REVENUE SERVICE – APPEAL NO: TAT/LZ/VAT/029/2019

Background

Value added tax ("VAT") by its nature is a consumption tax payable by a consumer of goods and services. In Nigeria, VAT is regulated by the Value Added Tax Act Cap V1, Laws of the Federation of Nigeria 2004 (as amended) ("VAT Act"). The VAT Act refers to goods and services taxable under the Act "taxable goods and services" except those specifically exempted by the Act. The applicable VAT rate is 7.5% on the value of all taxable goods and services.[1]

Not all goods and services are taxable under the Act as clearly provided under the First Schedule to the Act with the following being exempted goods: ***medical and pharmaceutical products, Basic food items, Books and educational materials, Baby products, Fertilizer, locally produced agricultural and veterinary medicine, farming machinery and farming transportation equipment, All Exports, Plant, machinery and goods imported for use in the export processing zone, Plant, machinery and equipment purchased for utilization of gas in downstream petroleum operations, Tractors, ploughs and agricultural equipment and implements purchased for agricultural purposes,[2] locally manufactured sanitary towels, pads or tampons***.[3] Similarly, the following services are exempted from the payment of VAT: ***Medical services, Services rendered by microfinance banks, people's Banks and Mortgage institutions, Plays and performances conducted by educational institutions as part of learning, All Export services[4] and tuition relating to nursery, primary, secondary and tertiary education***.[5]

[1] Section 4 of the VAT Act was amended by the Finance Act 2020 increasing the VAT rate from 5% to 7.5%.
[2] First Schedule of the VAT Act
[3] This item was included following the amendment by the Finance Act 2020.
[4] Part II, of the First Schedule to the VAT Act
[5] This item was included following the amendment by the Finance Act 2020.

The issue as to what should be classified as goods and services for the purpose of charging VAT was the subject of an appeal before the Nigerian Tax Appeal Tribunal ("TAT"). The TAT was called upon to determine whether rental income from real estate is subject to VAT under the VAT Act. The TAT held that lease of real property is a transfer of incorporeal right outside the scope of the VAT Act. This update offers an analysis of the issue and the basis of the TAT decision.

Brief Facts

This is an Appeal by the Appellant against the decision of the Respondent in respect of the Appellant's alleged tax liability for the 2014-2016 accounting years as set out in the Respondent's VAT Re-Assessment Notice dated July 9, 2019 (the "VAT Re-Assessment").

The Appellant invests and engages in the development of real properties which are rented or leased to tenants. The said properties are put to both commercial and residential purposes. The Respondent is an agency of the Federal Government responsible for the assessment, collection and general administration of federal taxes on behalf of the Federal Government of Nigeria including the VAT Act. Following a tax audit, the Respondent by a letter dated October 19, 2018 informed the Appellant of its intention to assess the Appellant to additional taxes particularly with respect to VAT on incomes derived from letting out its properties for the 2014 - 2016 accounting years. As a result of this letter, a series of meetings were held between the parties to reconcile the issues and correspondences were exchanged. The differences between the parties was irreconcilable and on July 9, 2018, the Appellant was served the Respondent's VAT Assessment Notice in relation to VAT on income derived from its commercial tenants. The Appellant objected to the said VAT Assessment Notice via its objection letter dated July 15, 2019 and on the 26th July 2019, the Respondent served its Notice of Refusal to Amend (NORA) dated July 22, 2019 on the Appellant. Dissatisfied with the Respondent's action, the Appellant filed its Appeal before the Tax Appeal Tribunal on August 22. 2019.

One of the grounds of appeal formulated by the Appellant was that the VAT assessment in the sum of N54,263,899.50 (Fifty-four Million, Two Hundred and Sixty Three Thousand, Eighth Hundred and Ninety-Nine Naira, Fifty Kobo)[6] as Value Added Tax ("VAT") on rental income earned by the Appellant in the period 2014 to 2016 is not provided for under the VAT Act and thereby unlawfully subjecting the rental income of the Appellant to VAT contrary to the provisions of the VAT Act. The Appellant prayed the Tribunal to set aside the VAT Assessment issued by the

[6] Approximately USD141,128.48 in US Dollars

Respondent against it as well as the penalties and interest imposed on the Appellant amongst other reliefs.

One major issue for determination by the TAT was whether rental income can be subject to VAT under the Value Added Tax Act. The Respondent in making a case against the appeal referred the TAT to the provisions of sections 2 and 46 of VAT Act and argued that rents on commercial real properties amounts to supply of goods for the purpose of VAT in Nigeria same not being exempt by the provisions of sections 2 and 46 of VAT Act. The Respondent contended further based on section 3 of the VAT Act that while letting out of taxable goods on hire or leasing is vatable, the letting of commercial property, unlike residential property, was not exempted in the First Schedule to the Act. On its part the Appellant submitted that rental incomes, residential or commercial, are not subject to VAT as the transactions giving rise to them do not constitute supply of goods and services under the VAT Act. The Appellant also argued that that since there can be no taxation without representation, there must be a direct link between the taxpayer and the liability sought to be imposed on a person. Therefore, no person should be subject to any tax if the taxing statute does not expressly provide for same. It further maintained that the tax liability of the Appellant as demanded by the Respondent must be determined by clear prescriptions of the VAT Act.

The TAT in arriving at its conclusion in this case considered the provisions of Section 46, the interpretation section on the meaning of "supplies" and "supply of goods" as well as the meaning of "goods" and "service". Supplies under the VAT Act was defined as ***"any transaction whether it is the sale of goods or the performances of a service for a consideration, that is, for money or money's worth".*** Supply of goods was defined as ***"any transaction where the whole property in the goods is transferred or where the agreement expressly contemplates that this will happen and in particular includes the sale and delivery of taxable goods or services used outside the business, the letting out of taxable goods on hire or leasing, and any disposal of taxable goods."***

By virtue of section 2 of VAT Act, VAT *shall be charged and payable* on *the supply of all* goods *and* services *(in this Act referred to as "taxable* goods and *services") other, than those* goods *and* services *listed in the First Schedule to this Act.* The above provision of the VAT Act shows VAT is charged and payable on the transaction itself and not on the consideration paid for the transaction. The tribunal noted that consideration paid for the transaction (in this Appeal, the rent) is only relevant to determine the actual amount to be paid as VAT. Thus, in determining whether VAT is payable or otherwise, it is the nature of the transaction that should be looked into and not the consideration paid for the transaction. Under the VAT Act, VAT is payable only in respect of supply of goods or services. Thus, for VAT to be chargeable on a transaction, the transaction must qualify as a transaction for supply of goods or services. In all the TAT therefore held that the Appellant's lease or letting of its real properties does not amount to a supply of goods or services.

Commentary

This case has reaffirmed the position of the law on the issue of whether rental income is subject to VAT or not and this is particularly for companies that have this as their major business to note.

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