UDO UDOMA & BELO-OSAGIE TAX UPDATE

TAX LIABILITY AND TAX OBLIGATIONS OF APPROVED ENTERPRISES ESTABLISHED IN AN EXPORT FREE ZONE

Introduction

The South-South Zone of the Tax Appeal Tribunal (the "TAT") sitting in Benin, on the 17th of March 2020, delivered its judgment in *Appeal No. TAT/SSZ/005/2018: West Atlantic Shipyard Limited v. Federal Inland Revenue Service.* In its judgment, the TAT held that there is an obligation on a company registered and operating in an Export Free Zone ("EFZ") to charge, deduct and pay value added tax ("VAT"), and to withhold tax on certain payments and make remittances to the tax authority when it transacts business with a company in the Customs Territory[1]. This obligation, however, will depend on the nature of the particular transaction.

Background

West Atlantic Shipyard Limited (the "Appellant") is a registered enterprise under the Oil and Gas Free Zone Act (Chapter 05) Laws of the Federation of Nigeria 2004 (the "Act") and conducts its business entirely within the Onne Oil and Gas Export Free Zone, Rivers State. The Appellant filed an appeal to challenge the Federal Inland Revenue Service's (the "Respondent") decision to subject the Appellant to a tax audit in contravention of the provision of the Act. The Appellant contended that the Respondent acted wrongly and unconstitutionally when it demanded Withholding Tax ("WHT") and VAT in the sum of €800,580 and $142,500 respectively by its letters dated 19th June, 2017 and 28th August, 2017 without regard to the Appellant's status as an approved enterprise within the EFZ. The Appellant further contended that the Respondent had acted unconstitutionally when, in a bid to forcefully collect the tax, the Respondent had directed the Appellant's bankers to freeze the account of the Appellant.

The Respondent's arguments were that whilst the Appellant was a licensee operating in an EFZ and not liable to pay income tax, the income accruing to the Appellant from the supply of services to customers in the Customs Territory is taxable under the Companies Income Tax Act 2004 (as amended) ("CITA"); and that the 'tax shield' granted to the Appellant as a licensee operating

[1] Customs Territory is other parts of Nigeria not an EFZ

in the EFZ applies only to the extent of their income which is earned in the EFZ.

Issues for Determination

The TAT formulated two issues for determination in the appeal, as follows:

(a) "*Whether an Approved Enterprise or a Licensee operating in an Oil and Gas Free Zone is required to deduct taxes from its customers in the Customs Territory and remit same to the Tax Authorities.*

(b) *Whether the Respondent had led any evidence showing that the Appellant is liable to the tax liability claimed by the Respondent".*

Decision of the TAT

After listening to the witnesses and a review of all the documentary evidence tendered by the respective parties, the TAT considered the provisions of Sections 8 and 18(1)(a) of the Oil and Gas Free Zone Act and Part 6, Paragraph 3 of the Nigeria Export Processing Zones Authority Investment Procedures, Regulations and Operational Guidelines for Free Zones in Nigeria 2004 (the "Regulations"). The TAT entered judgment in favour of the Appellant and found, upon the combined review and application of the statutory provisions mentioned above, that:

(a) the tax exemptions granted to approved enterprises under sections 8 and 18 of the Act are not absolute. They are subject to the exceptions stated in Part 6, Paragraph 3 of the Regulations. The TAT found also that an approved enterprise is required to deduct and remit VAT and WHT to the tax authority (depending on the nature of the particular transaction) when it transacts business with a company in the Customs Territory;

(b) for the approved enterprise to be liable to charge, deduct and remit tax, it must be shown that it, indeed, transacted business with a company within the Customs Territory and that the onus of proof of whether the transaction is subject to WHT and VAT lies with the taxing authority, in this case, the Respondent; and

(c) in the instant case, the Respondent did not provide evidence in the form of contract agreements or engagements between the Appellant and entities in the Customs Territory, which would have revealed the nature of the transactions and what qualifies such transactions for deduction of WHT and VAT charges. It is, therefore, not enough to merely state the entities with whom the Appellant transacted business which are located within the Customs Territory, as all forms of engagement do not necessarily qualify for tax deduction/ liability.

Commentary

The case under review has established that in any proceeding involving the determination of the tax liability of EFZ entities, the burden of proof lies with the tax authority, who is expected to show that the specific transaction carried out by the EFZ entity is subject to VAT and/ or WHT. Furthermore, whilst the statutory provisions make it unequivocally clear that companies registered and operating in the EFZs are exempted from income tax in relation to business operations with other EFZ entities in the EFZ, the 'grey area' has been whether they are also exempted from income tax, or have any tax obligations whatsoever with respect to income from business operations with entities located in the Customs Territory.

Tax Obligation vs. Tax Liability

A clear distinction needs to be made between a tax liability and a tax obligation. A tax liability is the existence of an incidence of tax for a company or an individual. In other words, a company or person is liable to tax when tax is imposed on the income of that person by a statute. A tax obligation, on the other hand, arises when a person has the responsibility to act as an agent of the tax authority by charging, withholding, deducting, collecting and remitting the tax that is imposed on the income of, or payment to, a third party, who is in fact the taxpayer that suffers the tax payment.

Thus, on the one hand, there is the obligation on the part of a supplier of taxable goods or services to charge, collect and remit VAT to the Federal Inland Revenue Service ("FIRS") and, on the other hand, there is the obligation on the part of a contracting party/ payer to deduct WHT on payments made to the recipient of a payment (if such payment is liable to WHT) and remit same to the relevant tax authority. For instance, does an EFZ enterprise have an *obligation* to charge

VAT when making supplies to a person in the Customs Territory? In addition, does an EFZ enterprise have a *liability* to suffer WHT on payments it receives from the recipient of the supplies in the Customs Territory?

To respond to the above questions, whereas the EFZ enterprise has an obligation to charge VAT, it does not have a tax liability, and payments to it for the supplies it makes to the Customs Territory should, therefore, not suffer WHT based on its tax-exempt status.

Another question is where the EFZ enterprise purchases taxable goods and services from an entity in the Customs Territory, does the EFZ enterprise have a liability to pay VAT? Also, does the EFZ enterprise have an obligation to deduct WHT from the payment it makes to the supplier in the Customs Territory? These are some of the questions that need to be considered when trying to determine the tax liability of an EFZ enterprise in structuring a transaction involving it.

The decision of the TAT makes it clear that EFZ enterprises are exempted from taxes with respect to all activities carried out in the EFZ with EFZ enterprises. Where, however, an EFZ enterprise carries out business activities with a person in the Customs Territory, the tax implication of the transaction will be determined by the nature of the specific transaction.

The Filing of Tax Returns

In practice, in order for the tax authorities to be able to determine the existence of a tax liability of an EFZ enterprise, the tax authority needs to have access to details of transactions that have transpired between the EFZ enterprise and third parties in the Customs Territory through the filing of returns.

In considering whether EFZ entities are obligated to file tax returns, Regulation 2(2) of the Oil and Gas Export Free Zone Regulations 2003, (the "Oil and Gas Regulations") provides that companies registered and operating within the EFZ are exempted from filing tax returns with any ministry or government entity, except to the Oil and Gas Export Free Zone Authority (the "Authority"). Furthermore, by Section 19 of the Act and Regulation 34(d) of the Oil and Gas Regulations, EFZ entities are required to submit to the Authority *such statistical data, information and returns as regards to the audited accounts, sales, purchases and other operations of the EFZ entity as may be prescribed by the Authority from time to time*, (although, in our view it is not clear that this includes the obligation to submit tax returns). Nevertheless, by part 6, paragraph 3 of the Regulations, EFZ entities are required to submit tax returns to the Authority who shall in turn submit the returns to the relevant tax authority.

Section 23 of the Act and Regulation 12 of the Oil and Gas Regulations provide that any enactment applicable in the Customs Territory shall apply in the EFZ unless such enactment is modified by the Minister of Industry, Trade and Investment. Part 6, paragraph 3 of the Regulations refers to section 40A of the Companies Income Tax Act 1979 (currently section 55 of the CITA). Section 55 of the CITA provides that companies whether or not exempted from incorporation shall file tax returns with the FIRS.

The TAT's decision in the case under review has established that not all business activities of EFZ entities with entities in the Customs Territory are subject to tax and that the tax waivers and exemptions granted to EFZ enterprises do not derogate from the need for them to deduct and remit taxes for specific transactions conducted with entities in the Customs Territory.

The views expressed in the update above are intended solely to provide general information on matters of interest for the personal use of the reader, who accepts full responsibility for its use. It is not a substitute for consultation with professional tax, accounting, legal or other competent advisers.

For questions or advice on issues discussed in this article or on any other relevant tax issues, please contact *taxteam@uubo.org*