

Jurisdiction over corporate taxation – the Federal High Court Judgment and the Tax Appeal Tribunal

In brief

On 30 October 2013, the Federal High Court (Abuja division) delivered its judgment in a case between an international construction company and the Federal Inland Revenue Service (FIRS).

The Federal High Court (FHC) ruled that the Tax Appeal Tribunal (TAT) had no jurisdiction to decide matters relating to federal revenue and taxation of companies in Nigeria. The FHC held that the powers of the TAT as provided by the FIRS Establishment Act were inconsistent with the constitution which gave the FHC exclusive jurisdiction on these matters. The FHC also ordered the Minister of Finance to disband the TAT.

In detail

Background

TSKJ II Construces Internacionais Sociadade LDA (“TSKJ II”), a nonresident company secured a contract for the construction of a gas plant in Nigeria and used TSKJ Nigeria to provide support services in the course of executing the contract.

In filing its returns on deemed profit basis, TSKJ II deducted the recharges paid as cost to its subsidiary. The FIRS disallowed the deduction on the basis that recharges were not deductible costs under the deemed profit basis of assessment. The FIRS issued additional assessments of about US\$12million on the company.

TSKJ II appealed to the TAT sitting in Abuja but the TAT decided in favour of the FIRS.

The taxation of non-resident companies on the deemed profit basis is a rule of thumb derived from Section 26 of the Companies Income Tax Act (CITA) which gives the FIRS discretion in certain circumstances, to determine the “fair and reasonable percentage of the turnover” of the company to be assessed to tax.

In practice, the FIRS deems a profit rate of 20% on turnover derived from Nigeria (implying a cost ratio of 80%). The estimated profit rate of 20% is taxed at 30% which results in an effective tax rate 6% of turnover.

Overview of the Federal High Court Judgment

Position of TSKJ II

The main issues raised by TSKJ II for determination by the FHC were:

- Whether on the state of the law, the tribunal had the jurisdiction to entertain the matter.

TSKJ II argued that the FHC had the exclusive jurisdiction to entertain matters relating to federal revenue and taxation of companies to the exclusion of any other court.

- Whether the TAT properly interpreted the provisions of CITA especially Section 26(1) in arriving at the conclusion that recharges by the appellant are not allowable deductions.

TSKJ II's argument was that the TAT erred in not following the decision of the FHC in the Halliburton case and that the TAT misinterpreted Section 26 of CITA. According to TSKJ II, Section 26 refers to "that part of the turnover" of a foreign company where it executes a contract with its fixed base and not contracts with a third party.

- Whether the TAT was right in refusing to follow the previous decision of the FHC in the case of Halliburton West Africa Limited V FBIR.

TSKJ II contended that the TAT was duty bound to follow the decision of the FHC since the facts of the case was similar to the facts of the Halliburton case.

Position of the FIRS

The FIRS argued that the jurisdiction of the TAT did not conflict with the exclusive jurisdiction of the FHC as the TAT is merely an administrative panel created by the FIRS Establishment Act and not a court with competing jurisdiction as contemplated by Section 251(1) of the Constitution. To buttress this position, the FIRS mentioned that appeals lie directly to the FHC and not to the Court of Appeal as is the case with the defunct VAT Tribunal as provided by the VAT Act.

The Judgment

On the issue of jurisdiction, the FHC dismissed the FIRS' argument that the TAT was a mere administrative panel on the basis that the decisions of the TAT affect the civil rights and obligation of companies in relation to taxation in Nigeria.

It held that certain sections of the FIRS Establishment Act relating to the powers of the TAT to determine disputes on companies' taxation and federal revenue are inconsistent with the provisions of section 251(1) of the Constitution and therefore void to the extent of such inconsistency.

On the other issues raised by TSKJ II, the FHC ruled that based on the principle of '*stare decisis*', the TAT is bound by the decision of the FHC in the Halliburton's case and should have decided this case in the same way.

The FHC set aside the decision of the TAT against TSKJ II and made consequential orders to restrain the TAT from adjudicating on corporate taxation and federal revenue. The FHC also ordered the Minister of Finance to disband the 8 recently reconstituted Tax Appeal Tribunals.

The Effect of the Judgment

This judgment leaves the Halliburton decision as the only valid judgment on the deductibility of recharges for assessing non-residents to deemed profit basis of taxation.

The decision bars the TAT from entertaining matters bothering on taxation of companies and federal revenue (an important reason for the establishment of the TAT) until it is overturned or quashed on appeal.

However, after the judgment, the TAT has continued to consider pending appeals partly because the FIRS has appealed the judgment and also made an application for stay of execution of the judgment.

The implication of the decision may be considered retrogressive by many taxpayers who consider the TAT as the fastest way to resolve pending disputes with the tax authorities. However, it gives some taxpayers who have been aggrieved by decisions of the TAT a basis to request that such decisions be set aside.

Until conclusively determined by the highest court, the deemed profit basis of assessment and treatment of recharges will continue to be a controversial issue. Nonresident taxpayers who do not wish to contend with this uncertain tax position should consider adopting the actual profit basis of assessment. This may however cost more in terms of time to compute and file the tax returns and to deal with tax audit.

Let's talk

For a deeper discussion, please contact your PwC team:

Taiwo Oyedele
+234 1 271 1700 Ext 6103
taiwo.oyedele@ng.pwc.com

Kenneth Erikume
+234 1 271 1700 Ext 6110
kenneth.y.erikume@ng.pwc.com

Moshood Olajide
+234 1 271 1700 Ext 6115
moshood.olajide@ng.pwc.com