

# ***Federal High Court issues judgment on liability to Nigerian taxes by non-resident companies***

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## ***In brief***

The Federal High Court (FHC) has ruled that CIT and WHT are applicable on income “derived” from Nigeria by non-resident companies, without regard to whether these companies have a taxable presence in Nigeria or not. The ruling however excluded non-resident companies from Nigerian VAT payment obligations. We expect the judgment to be appealed.

## ***In detail***

### ***Background***

The Companies Income Tax Act (CITA) is the guiding legislation for the taxation of all companies except those in the upstream sector in Nigeria. Section 9(1) of this Act (LFN 2004) provides that income tax is chargeable on...

*“...the profits of any company accruing in, derived from, brought into, or received in, Nigeria...”*

While the terms ‘brought into’ and ‘received in’ do not require further clarification, the law defines separately what constitutes ‘derived from’. This definition presupposes that activities of a non-resident must be carried on physically within Nigeria.

### ***Overview of the court judgment***

#### ***Position of the Plaintiffs***

The principal plaintiff was Saipem Contracting Nigeria Limited (NigCo) which provides drilling, construction, fabrication and maintenance, to companies in the oil and gas industry in Nigeria.

The company and its non-resident related entities based in Portugal and France (PortCo and FrenchCo respectively), entered into contract arrangements with Shell Nigeria Exploration and Production Company Limited (SNEPCo) to carry out different services.

The non-resident companies carried out their responsibilities under these contracts outside Nigeria.

The FIRS subsequently issued tax assessments to PortCo and FrenchCo.

The issues for determination brought forward by NigCo, PortCo and FrenchCo were:

- Whether in line with the applicable tax laws, VAT, WHT and CIT should apply on the income earned by the non-resident companies from the execution of their responsibilities under the contracts (including FrenchCo since there is an existing double tax treaty between Nigeria and France);
- Whether the FIRS is empowered to go back on its earlier ruling to FrenchCo and PortCo which exempted them from CIT, VAT and WHT;
- Whether the FIRS is also permitted to go back on an earlier ruling to the local

entity which exempted the income earned from its fabrication (manufacturing) activities from WHT.

### *Position of the FIRS*

The FIRS argued that NigCo created a fixed base for PortCo and FrenchCo and therefore a tax obligation.

The issues put forward by the FIRS for determination were:

- Whether the contractual relationship between the non-resident entities and SNEPCo should be subjected to tax in Nigeria;
- Whether the tax treaty between Nigeria and France will result in a reduced or nil Nigerian tax liability for FrenchCo.

SNEPCo's position was that Nigerian taxes are the responsibility of the plaintiffs except VAT which is the consumer's obligation.

### *The judgment*

The court held that the income earned by the non-resident companies was liable to CIT and WHT in Nigeria on the basis that the income was derived from Nigeria.

The judgment appears to suggest that all income arising from a contract with a Nigerian company is subject to tax, even if the services are provided outside Nigeria.

The court also held that the FIRS could reverse its earlier rulings exempting the non-resident entities from taxes in Nigeria, as such rulings by the FIRS were illegal if not supported by the tax laws.

The court further ruled that assessing the income earned by FrenchCo to CIT and WHT did not conflict with the provisions of the tax treaty between Nigeria and France on the basis that the purpose of treaties is not to shift tax revenue between countries, but to ensure that it does not suffer tax twice. On this basis, the judge assumed that Nigeria can tax the income of the non-resident companies.

In respect of VAT, the court ruled that VAT is a consumption tax paid by the consumer of goods and services, and thus the non-resident companies were not liable to VAT despite the wordings of the contracts.

### *The takeaway*

Taxpayers can rely on one of the conclusions reached in the judgment.

**Tax rulings:** Tax rulings issued by the FIRS cannot be relied upon if there is no clear basis in the law.

Through the action of the FIRS to pursue this case, it seems the FIRS is now willing to rescind its earlier views where necessary. We are of the view

that this increases tax uncertainty and is not healthy for the tax system. Any reversal of FIRS ruling should not have a retroactive effect.

Taxpayers should therefore exercise caution in applying favourable tax treatments or incentives if not based on clear legal provisions.

### *Issues requiring more clarity*

On WHT on fabrication, WHT may be applicable on fabrication activities depending on the circumstances.

It should be noted that 'sales in the ordinary course of business' are the only transactions specifically exempted from WHT under the Regulations. The FIRS issued a circular stating that manufacturers are not liable to WHT on their products. Also, in this case, the FIRS issued a letter to NigCo confirming that local fabrication is considered manufacturing and therefore not subject to WHT.

In our view, all sales in the ordinary course of business are exempt from WHT (not only the examples listed in the FIRS circular). To the extent that fabrication cannot be categorised as "construction contract" it should be considered as sales in the ordinary course of business. Unfortunately the case did not make any distinction with reference to the law/regulations and this still remains unclear.

On the issue of imposing WHT on the non-resident entities, Nigerian tax law does not impose tax by assuming that income is derived from Nigeria because the counterparty is a Nigerian entity, the contract is subject to Nigerian law or payments are being made from Nigeria.

The position of this judgment conflicts with the legal conditions under which the income of a non-resident company is deemed to be derived from Nigeria. The income is deemed as 'derived from' Nigeria under Section 13(2) of CITA 2004 if the company has a fixed place of business in Nigeria through which it carries on business (among other conditions).

Subjecting any payment by a Nigerian company to tax will mean that certain transactions such as online sales by foreign companies and purchases abroad (including hotel accommodation) by Nigerian entities

will be subject to tax in Nigeria. This is regardless of whether anyone from the foreign company entered Nigeria. This clearly goes against the express and implied intention of the law and international best practice.

In an unclear manner, the judge also ruled that the existing double taxation treaty with France did not have any impact on whether FrenchCo should be subject to tax in Nigeria. The treaty clearly sets out in Article 5 the conditions under which Nigeria can impose income tax on the business profits of a French company. Significantly, this would require the French company to have a fixed base through which it carries out business or has dependent agents in Nigeria (i.e. a permanent establishment must be triggered).

The judgment in this instance goes against the principle of tax treaties, which provides specific guidelines in

respect of the taxation of the business profits of residents of treaty countries.

With reference to the ruling on VAT, there was never a question about who was liable, as clearly the responsibility for this rests with the consumer.

Unfortunately, the judgment did not address the real VAT issue, which is whether non-resident entities are obliged to register for and charge VAT if they are not carrying on business in Nigeria and whether the customer is required to reverse charge itself for VAT. The FIRS has consistently insisted on this practice even though it has no basis in the VAT Act.

It is expected that NigCo, PortCo, and FrenchCo will appeal the case and hopefully, the dispute will be considered based on tax law principles and robust technical grounds.

## ***Let's talk***

For a deeper discussion of how this issue might affect your business, please contact:

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