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TAT rules on legitimate expectation, and the application of VAT and other taxes on the operations of an airline in Nigeria

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Background

Kenya Airways Limited (the "Company") commenced business in Nigeria in 1999. Between 1999 and 2014, the Federal Inland Revenue Service (FIRS) assessed foreign shipping companies and airlines operating in Nigeria to Companies Income Tax (CIT) at the minimum tax rate of 2% on sums received in respect of the carriage of passengers, animals or other goods loaded in Nigeria. This is in line with Section 14(4) of the CIT Act.

The Company remitted its taxes and obtained Tax Clearance Certificates (TCCs) from the FIRS in line with this practice, during this period. However, the FIRS issued a Public Notice in 2015, requiring Non- Resident Companies (NRCs) to prepare and submit their tax returns based on their actual profits earned from Nigeria. In the Public Notice, the FIRS stated that where actual profits could not be satisfactorily determined, the FIRS retained the rights to assess such NRCs to tax under the "deemed profits" approach. This approach entails deeming a 20% profit margin, which is then subjected to CIT at 30% (resulting in an effective tax rate of 6% on turnover). This is in line with Section 30 and 14(3) of the CIT Act.

Further to this, the FIRS assessed the Company to additional CIT, Value Added Tax (VAT) and Withholding Taxes (WHT), including penalties and interest, for the 2009 to 2014 financial years. The Company objected to the assessment and approached the Tax Appeal Tribunal (TAT). We have highlighted the key points from the ruling, and included our takeaway comments below:

The Company's argument

Kenya Airways argued that the application of the "deemed profits" rule in Section 14(3) of CITA (i.e 6% of Nigerian turnover) by the FIRS was only brought about by the Public Notice issued in 2015, which had an effective date of 1 January 2015. Therefore, applying this to a period earlier than 2015 translated to retrospective application. The Company also relied on the principle of legitimate expectation as the FIRS had historically subjected NRCs operating in Nigeria to CIT, based on Section 14(4) of CITA (i.e 2% on Nigerian turnover).

With regards VAT on commission for sale of its flight tickets, the Company argued that ticket sales were done by its ticketing agents to customers through a platform, the configurations of which did not allow the Company to charge/deduct VAT. Kenya Airways also argued that they did not deal with the customers themselves and had no control over the setup or management of the platform.

Kenya Airways maintained that it duly deducted WHT on qualifying transactions, and had provided relevant receipts to the FIRS.

The Company also argued that penalties and interests should not apply on the additional assessments raised as the tax is not yet payable and the assessment is not final and conclusive.

FIRS' argument

The FIRS argued that applying the 6% rate under the deemed profits rule was justifiable in the circumstances, as the Company had failed to provide satisfactory information including its audited accounts for the period. The FIRS further stated that it was not compelled to apply the 2% minimum tax under Section 14(4).

On VAT, the FIRS argued that the services rendered by the agents are "VATable", and therefore VAT should have applied on the commissions paid to the agent. The failure to provide an enabling system for charging VAT, did not absolve Kenya Airways of the responsibility for VAT payments to the FIRS.

Also, the FIRS maintained that the Company was subject to WHT, and was required to remit WHT since its business relates to commission and agency.

With regards to penalties and interest, the FIRS argued that where additional assessments arise from the failure of the Company to keep adequate records and properly assess itself, penalty and interest will arise.

Decision of the TAT

The TAT ruled that:

1. In line with the doctrine of legitimate expectation, any additional CIT assessment on periods before 2015 should be based on the rate of 2%. The FIRS' Public Notice was stated as being effective from 1 January 2015, and therefore for 2009 to 2014, the Company was entitled to expect that the FIRS would not deviate from its existing practices.
2. The commissions paid to the agents are not exempt under the VAT Act. As such, Kenya Airways is a supplier of taxable services and is therefore deemed to be a collection agent; and having failed to charge VAT on the commissions paid by it to its agents, is liable for the additional VAT assessment along with interest and penalties on VAT.
3. Kenya Airways is liable to the additional WHT liabilities on qualifying transactions.
4. On interest and penalties, it was held that where a taxpayer's appeal fails, the tax liability along with the penalty and interest become payable from the due date of the original taxes.

Analysis and Takeaway

It is interesting to highlight the application of the doctrine of legitimate expectation in resolving tax disputes. The TAT in this case relied on fairness and consistency in interpreting the FIRS' actions on 14(3) of CITA. In the current dynamic tax terrain, this may provide some comfort to taxpayers who rely on certain tax practices which have historically been upheld by the FIRS, to the extent that they are supported by the laws.

The party referred to in the judgment is Kenya Airways Limited, an entity incorporated in Nigeria. However, Section 14 of CITA only applies to foreign companies, and the relevant income under contention is with regards to carriage of passengers and goods from Nigeria in international travel - activities performed by the NRC. It therefore appears that the FIRS assessed the Nigerian agent to CIT relating to its foreign principal. Companies with similar structures should therefore be mindful of this practice.

With regards VAT on ticketing commissions, the provider of the service is the agent, who therefore has the duty to charge, collect and remit the VAT in line with the VAT Act. The basis on which the TAT imposed the obligation for VAT on the airline was not clear. From a practical perspective, the commission invoice should be issued by the agent, depending on the contracting arrangements.

Requesting for the VAT from Kenya Airways may result in the FIRS double-dipping, as FIRS may also assess such agents for VAT on their revenue in line with the law.

In any event, going forward, the self-charge rule introduced in the VAT Act by the Finance Act 2019 would require airlines to self-charge VAT on such supplies if it can be determined that the agency services are not exported.

Taxpayers with pending audits or other disputes around this issue may need to perform an evaluation for historic periods since the judgment imposes a rule to self-charge which was not in the law before the Finance Act 2019, similar to the Tourist Company of Nigeria TAT decision [see link].

Finally, businesses need to conservatively reassess their risk of exposure to penalties and interest from tax defaults, considering this judgment (and other previous TAT decisions) which rule that they apply from the date the taxes became due.

For a deeper discussion, please contact any member of our Tax Controversy and Dispute Resolution team below:

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