

Tax Appeal Tribunal upholds deemed profits assessment but fails to determine whether FIRS validly exercised its discretion

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Background

Section 30(1)(b) of the Companies Income Tax Act (CITA) grants FIRS a discretion to assess foreign companies to tax on a *fair and reasonable percentage* of their turnover where it appears to FIRS that the company either has no assessable profits or assessable profits that are less than expected or the profits of such companies cannot be ascertained. This is called a Deemed Profits Assessment [DPA]

In practice, the FIRS deems 20% of a company's turnover as its profits and then subjects this notional profit to tax at 30%, resulting in an effective tax rate of 6% of turnover. Due to challenges of determining the tax attributes of foreign companies, such companies are taxed on this basis. Therefore such companies paid tax whether or not they made profits.

However, sometime in 2015, FIRS directed all foreign companies with Nigerian operations to file tax returns based on their actual profits based on section 55 of CITA (i.e. based on the profits determined from their audited accounts after adjustments and capital allowances).

Facts

In accordance with FIRS' 2015 directive, BJ Pumping Service SA Panama (BJP), a foreign company with Nigerian operations filed its 2015 – 2017 tax returns based on its actual profits. In those years, BJP had no assessable profits so it was not expected to pay any tax. FIRS refused the returns, issued a DPA and imposed 6% tax on the Company's turnover. The Company objected to the DPA and subsequently appealed to the Tax Appeal Tribunal.

Taxpayer's arguments

The Company argued that:

- FIRS' power under section 30(1)(b) was a discretionary one and should have been exercised in accordance with the *Wednesbury principles* – that is, in good faith, considering relevant factors while ignoring irrelevant factors.
- FIRS did not validly exercise its discretion because it did not audit the Company's books as was suggested in *Mobil v. FBIR*¹ and failed to consider the downturn in the oil and gas industry at the time, more so S.30 is an anti-avoidance provision which should be applied to incidences of tax avoidance.
- 20% did not reflect a fair and reasonable percentage of a company's taxable profits given the economic realities of the oil and gas industry during the relevant years.

FIRS' arguments

FIRS argued that once the conditions in S.30 are met it could validly exercise its discretion, the Company had no assessable profits, and the Company's losses were as a result of harmful transfer pricing and tax avoidance schemes.

Issue for Determination

The Tribunal raised a sole issue: *Whether the circumstances in the Appellant's tax returns for 2015-2017 years of assessment, necessarily triggered the invocation of Section 30 of the Companies Income Tax Act, by the Respondent.*

The Decision

The Tribunal raised new issues that were not considered by either party and, without taking arguments from both parties on those issues, upheld FIRS' DPA. The Tribunal did not comment on the propriety of FIRS' exercise of discretion given the facts adduced in evidence. The Tribunal did not also consider the evidence elicited from FIRS' witness during cross-examination suggesting that the witness had no knowledge of transfer pricing to comment on the Company's related party transactions, and documentary evidence relied on by FIRS which suggested a downturn in the oil and gas industries for the relevant years.

Takeaway

The appeal was an opportunity for the Tribunal to pronounce on the extent of FIRS' discretionary power under S.30. However, the Tribunal did not review the exercise of the power in line with the evidence before it.

Interestingly, the Tribunal did not expressly uphold FIRS' arguments that once the conditions in S.30 were met then FIRS could exercise its discretion to assess taxpayers under DPA without restriction. This is an important point because a taxpayer may be caught by the conditions of S.30 but have valid and justifiable reasons e.g. where there is a downturn in an industry as was the case with the Company in the appeal.

The Tribunal also lost the opportunity of pronouncing on the fairness and reasonableness of imposing 20% as deemed profits on all categories of taxpayers regardless of the industry and current economic climes. To pass the test of being fair and reasonable, the percentage applied on turnover must reflect the industry, current economic conditions and the industry average.

Taxpayers may still challenge any arbitrary exercise of discretion by the FIRS as there is a precedent in *G4S v. LIRS*² delivered by a previous panel of the Tribunal.

For a deeper discussion, please contact any member of our **Tax Dispute Resolution team** below or your usual contact within PwC Nigeria:

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