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PwC Tax Alert

TAT rules on the applicability of Withholding Tax on management fees paid to a non-resident company

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Background

Nigeria LNG Limited (NLNG) is a Nigerian company that primarily liquefies natural gas for sale to its customers. NLNG has a foreign vessel leasing/shipping subsidiary – Bonny Gas Transport Limited (BGT). BGT leases vessels to NLNG under a Long-Term Time Charter Party Agreement (TCPA). In turn, BGT entered into a Vessel Management Agreement (VMA) with a UK company ("UK Co"), to manage the vessels. The VMA allows NLNG to act on behalf of BGT under the agreement, including reimbursing for management fees due to UK Co.

The FIRS audited NLNG for the 2010 - 2014 financial years and issued a WHT assessment of about $3.25 million in respect of management fees paid to UK Co, including interests and penalties. NLNG objected to the assessment and subsequently appealed to the Tax Appeal Tribunal (TAT).

Issues for determination

NLNG's arguments

- The management fees were earned by UK Co, outside Nigeria, in respect of the VMA with BGT. Therefore, they are not liable to WHT as the income was not derived from, accrued in, received in, or brought into Nigeria.
- WHT should not apply on the management fees as they were reimbursements to BGT for expenses incurred to UK Co.
- In the unlikely event that the TAT concludes that the management fees were earned by BGT, WHT should still not apply, considering the special exemptions under the NLNG Act to foreign contractors that provide services outside Nigeria.
- Interest and penalty should not apply as there is no WHT.

FIRS' arguments

- The payment to BGT was not a reimbursement, as BGT had the original obligation to carry out the vessel leasing and management services based on the TCPA and VMA. NLNG cannot reimburse BGT for an obligation originally intended for BGT.
- The VMA between BGT and UK Co envisaged that UK Co would come into Nigeria to train and transfer ship management knowledge to NLNG staff, and there was no indication that the training would take place outside Nigeria. To this extent therefore, UK Co's income was liable to tax in Nigeria.
- The TCPA executed between NLNG and BGT was artificial.
- Interest and penalties accrue from the due date for deduction of the WHT.

The Tribunal's Decision

The Tribunal agreed that the FIRS could disregard the agreement between NLNG and BGT, and that the management fees were in fact, made to UK Co by NLNG. Therefore, the real issue is whether NLNG was obliged to deduct WHT on such management fee payments.

The Tribunal held that the management fees earned by UK Co was "sourced" from Nigeria (i.e. paid by NLNG), and emphasised that Non-Resident Companies (NRCs) create a nexus for tax by transacting within or into Nigeria. On this basis, such fees were taxable in Nigeria and NLNG was therefore obliged to deduct WHT.

The Tribunal also countered NLNG's position that the fees are not taxable in Nigeria because UK Co did not create a taxable presence under Section 13(2) of CITA. The Tribunal held that for the avoidance of doubt, UK Co had a fixed base in Nigeria because certain NLNG employees performed inspection and other relevant activities in Nigeria on behalf of UK Co.

The TAT referred to a number of previous judgments to support the view that a foreign company could create a fixed base even without a permanent place of business in Nigeria; and concluded that the management fees were taxable in Nigeria and therefore subject to WHT.

The TAT also ruled that the FIRS was justified in assessing interest and penalty, and stated that an appeal does not eliminate but only suspends interest and penalty, until final determination.

Analysis and Takeaway

A number of decided cases support the treatment of an item described as a reimbursement in a contract as not subject to WHT to the extent that it is payable on behalf of another party. However, this TAT judgment now suggests that the FIRS can disregard the wordings of a contract or any arrangement (especially where it is between related parties), if the FIRS takes the view that such arrangement is artificial. The basis for reaching this conclusion on artificiality was not exhaustive. For example, the TAT neither considered the commercial or practical reasons for setting up BGT nor did they compare with similar transactions in the vessel leasing industry in line with standard tests in other jurisdictions.

Although the Tribunal subsequently analysed whether a taxable presence was created, the TAT's initial view that the management fees were taxable in Nigeria because they were paid by NLNG appears generic and simplistic. This interpretation would render the entire Section 13 (which imposes tax on active income of non-resident companies) redundant, except for instances where the non-resident company receives payment from outside Nigeria. In addition, prior to the introduction of the Significant Economic Presence (SEP) rules, active income earned by NRCs were primarily subject to tax (including WHT) in Nigeria only if there was sufficient nexus such as having some level of physical presence or dependent agent, or through transfer pricing adjustments.

The TAT stated that the intention of the pioneer holiday granted to NLNG cannot be to exclude WHT on payments to third parties. This view seems to have ignored the specific provision in the NLNG Act that grants tax exemptions to non-resident companies in respect of services performed outside Nigeria to NLNG as part of the company's fiscal incentives as provided under the NLNG Act rather than the Industrial Development Act.

The TAT also concluded that activities under the VMA resulted in a fixed base for UK Co in Nigeria, even though submissions by NLNG indicated that certain activities (such as training) were carried out in the UK, and facilities were rented in the UK for that purpose. The TAT did not make any commentary on whether UK Co met the treaty conditions to trigger a Permanent Establishment (PE) which would be relevant to determine whether WHT should apply on payments to UK Co in line with the Nigeria/UK DTA. The TAT's ruling on interest and penalties is consistent with previous rulings in this regard.

Overall, businesses need to reassess their exposure to WHT liability on transactions with non-resident providers based on this ruling.

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