

## **THE NEW FACE OF VAT IN NIGERIA: WHAT NIGERIAN BUSINESSES AND CONSUMERS SHOULD KNOW**

### *Introduction*

On 13<sup>th</sup> January, 2020, President Muhammadu Buhari signed the Finance Bill (now Finance Act 2019 (the “Finance Act”)) into law. The Finance Act was gazetted on 14<sup>th</sup> January, 2020 with a commencement date of 13<sup>th</sup> January, 2020. The Finance Act amends the major tax legislation in Nigeria to align with the Federal Government’s monetary and fiscal reform policies.

Of particular concern to businesses and consumers with regard to the Finance Act is perhaps the introduction of a new Value Added Tax (“VAT”) system, and an increase in the VAT rate from 5% to 7.5%, based on the amendments made to the Value Added Tax Act (Chapter V1) Laws of the Federation of Nigeria 2004 (as amended) (the “VAT Act”). Besides the

increment of the VAT rate, there are other notable amendments to the VAT Act which will impact the business landscape in Nigeria.

We have highlighted below some of these amendments, our thoughts and comments on them and the possible impacts which these changes could have on entities doing business in Nigeria.

### *Increase in the VAT Rate*

The Finance Act increases the VAT rate by 50% from 5% to 7.5%. While this will increase the amount of revenue generated from VAT by the government, it will also lead to increases in the prices of taxable goods and services. Although the Finance Act has a commencement date of 13<sup>th</sup> January, 2020, the Minister for Finance, Budget and National

Planning announced 1<sup>st</sup> February, 2020 as the commencement date for the implementation of the VAT rate of 7.5%. What this means is that from that date, entities that are registered for VAT (excluding small companies - i.e., companies with less than NGN25 million annual turnover) must include VAT at the rate of 7.5% on invoices for the supply of taxable goods and services.

### *Commencement of Business Clarified*

Registration for VAT (and filing of returns) is now upon commencement of business. Unlike in the past when it was not clear when a taxable person could be deemed to have commenced business, the Finance Act now has a description of what constitutes commencement of business. The Finance Act now makes it clear that a business shall be deemed to have commenced in Nigeria on the day that the entity carries out its first transaction. This shall be the earliest of the dates on which it: (a) begins to market or first advertise its products or services for sale; (b) obtains an operating licence from a regulatory authority in Nigeria; (c) first sale or purchase; (d) executes its first trading contract after incorporation; (e) issues or receives its first invoice; (f) delivers or receives its first consignment of goods; or (g) first renders services to its customers.

### *Place of Supply Rules now Apply*

There have been debates over the years regarding the application of VAT to the services provided outside Nigeria by a non-resident company to a person resident in Nigeria. The Federal Inland Revenue Service (“FIRS”) held the view that such services should be subject to VAT in Nigeria because the recipient of the service is resident in Nigeria, while taxpayers were of the view that the such

services were not liable to VAT in Nigeria. These positions were the arguments of the parties in the case of Vodacom Business Nigeria Limited v FIRS (*Appeal No. CA/LA/L/556/2018*) where the Court of Appeal applied the “destination principle” rule and held that the supply of satellite network bandwidth capacities by a non-resident company to a Nigerian company was liable to VAT in Nigeria. In line with this decision, the “destination principle” rule for goods and services has now been incorporated into the VAT Act by the Finance Act.

Consequently, the Finance Act provides that VAT is chargeable and payable on the supply of all taxable goods and services in Nigeria other than those specifically exempted from the tax under the Act. Goods are deemed to be supplied in Nigeria where the goods are (a) physically present in Nigeria at the time of the supply, (b) imported into Nigeria for use by a person, (c) assembled or installed in Nigeria, or (d) the beneficial owner of the rights in or over the goods is a taxable person and the goods or right is situated, registered or exercisable in Nigeria. On the other hand, services are deemed to be supplied in Nigeria if the services are rendered in Nigeria by a person physically present in Nigeria at the time that the service was provided or the services are provided to a person in Nigeria irrespective of where the services are rendered from.

In view of the foregoing, the description of the various circumstances under which taxable goods and/or services are deemed to be supplied in Nigeria has broadened the scope of goods and services that are subject to VAT in Nigeria. One notable effect of this provision is that businesses and consumers in Nigeria are now clearly required to pay VAT on taxable goods

and services supplied to them regardless of where the supplier of such taxable goods and services is located.

#### *Transfer of Assets Used for Trade or Business between 'Related Parties'*

As an incentive to make the cost of transaction between related parties easier, the Finance Act has exempted assets in respect of trade or business transferred among related parties from VAT if the prescribed conditions are met. Under the law (a) where a trade or business carried on by a company is sold or transferred to a Nigerian company for the purpose of better organisation of that trade or business or the transfer of its management to Nigeria, and (b) any assets employed in such trade or business is sold or transferred, no VAT shall apply to the sale or transfer of the assets to the extent that (i) one company has control over the other; or (ii) both are controlled by some other person; (iii) are members of a recognised group of companies and have been so for a consecutive period of at least 365 days prior to the date of the reorganisation.

If the acquiring company subsequently disposes of such assets within 365 days after the date of the transaction, the VAT exemption shall be rescinded and the companies shall be treated as if they did not qualify for the exemption as at the date of the initial transaction. In such a scenario, VAT will apply to the transfer of the assets as appropriate.

#### *Intangibles are now Subject to VAT*

The Finance Act has expanded the definition of "goods" to include any "intangible product, asset or property over which a person has ownership or rights, or from which a person derives benefits, and which can be transferred

from one person to another excluding interest in land". What this means is that the transfer/assignment of intangibles (such as intellectual property rights, assignment of contractual rights and rights in oil and gas licenses, royalty, shares etc) is now subject to VAT in Nigeria. Over the years, there has been a controversy as to whether intangibles could be classified as goods under the VAT Act to become liable to VAT.

The position before the enactment of the Finance Act was that intangibles were not goods and, therefore, not liable to VAT and this position was upheld by the Federal High Court in the case of *CNOOC Exploration and Production Nigeria Limited vs. the Federal Inland Revenue Service & Others*. The Court held in that case that the contractor's rights in a production sharing contract do not constitute either "goods" or "services" as contemplated by the VAT Act and that the assignment of the rights by the contractor was not liable to VAT under the VAT Act. This was the position of the law regarding the applicability of the VAT Act to intangibles prior to the amendment of the VAT Act by the Finance Act. The definition of goods in the Finance Act to include intangibles has now reversed the decision of the Federal High Court in the CNOOC's case.

The sale of land is, however, exempted from the definition of goods. This means that the sale of land will not be liable to VAT.

#### *Expansion of Taxable Services/Supplies*

The Finance Act now defines services to mean "anything other than goods, money or securities which is supplied excluding services provided under a contract of employment". This is an extensive definition which is wide enough to cover,

other than the services specifically exempted, every type of services provided by or to persons resident in Nigeria.

The law has also provided a definition of taxable supplies. It defines the term to mean “*any transaction for sale of goods or the performance of a service, for a consideration in money or money’s worth*”. This definition suggests that any transaction for the sale of goods or the performance of services which does not come within any of the exemptions will be liable to VAT. If no actual cash is payable and the consideration is money’s worth, the amount of VAT will be determined and computed based on the market value of the good or service. This is because the VAT Act requires that the value of the supply of taxable goods and services shall be, where the supply is for a consideration not consisting of money, the market value of the goods or services. In such a case, the open market value of such taxable goods or services shall be taken to be the amount that would be payable by a person in a transaction at arm’s length.

#### *Reverse Charge Mechanism now Applies in Nigeria*

The Finance Act introduces the “reverse charge” mechanism in respect of the goods and services provided by a non-resident company to a Nigerian-based customer. Reverse charge is a mechanism that requires the recipient of taxable goods and services to pay the withhold and remit the applicable VAT instead of the supplier. The Finance Act imposes an obligation on a non-resident company to include VAT on its invoices for the supply of taxable services to a Nigerian resident entity. It further requires the Nigerian resident person to whom such services are supplied in

Nigeria to withhold and remit VAT directly to the FIRS in the currency of payment.

Where a taxable person to whom taxable supplies is made in Nigeria is issued an invoice on which no tax is charged by a non-resident company, the Finance Act requires that such Nigerian recipient must self-account for the VAT payable and remit same to the FIRS. The effect of this is that Nigerian customers of non-resident companies that are supplied taxable services in Nigeria are required to self-account for the applicable VAT even if the non-resident company does not include VAT on its invoice.

#### *Utilisation/Refund of Tax Credit*

A taxable person that purchase or import goods for resale or purchase goods which form part of the stock-in-trade used for the direct production of any new product on which output VAT is charged is entitled to a tax credit if the input tax paid exceeds the output tax collected which it could utilise as a credit against subsequent months. Such a taxable person would be entitled to a refund from the FIRS, of excess tax not utilised as a credit, upon provision of such documents as the FIRSe may require.

#### *Exported Service now has a New Meaning*

The Finance Act amends the definition of exported service to mean “*a service rendered within or outside Nigeria by a person resident in Nigeria, to a non-resident outside Nigeria; Provided that a service provided to a fixed base or permanent establishment of a non-resident person in Nigeria shall not qualify as exported service*”. Consequently, a service provided within

or outside Nigeria by a person resident in Nigeria to a person resident outside Nigeria would qualify as an exported service not liable to VAT. However, where the service is provided within or outside Nigeria by a person resident in Nigeria to a fixed base or permanent establishment of a non-resident person in Nigeria, such a service will not qualify as exported service and will, therefore, be liable to VAT.

### *Expansion of VAT Exemption List*

The list of items exempted from VAT has been expanded to include a detailed breakdown of what constitutes basic food items, locally manufactured sanitary towels, tuition (primary, secondary and tertiary), and services rendered by microfinance banks and mortgage institutions. The “basic food items” exempted include bread (brown and white), cereals, fish of all kinds, flour and starch meals, fruits, roots such as yam, meat and poultry products, milk, salt, and herbs as well as natural water and table water. This is commendable as it will help businesses providing the exempted goods and services to be competitive.

### *Introduction of ₦25 Million Revenue Threshold for VAT Filing*

Companies with an annual turnover of ₦25 million or less are classified as small companies by the Finance Act and are exempted from including VAT in their invoices, collecting and remitting VAT and filing monthly VAT returns to the FIRS. Whilst this is a welcome development which will reduce the tax compliance obligation of small companies, it is not clear how taxable persons that do not meet the VAT filing threshold will be able to recover the input tax that they may incur in carrying out their operations. The Finance Act is also

not clear on the point when a company would be deemed a small company – whether at the beginning of each accounting year (relying on the preceding year financial statements) or at the end of each accounting year after which a company has prepared its financial statements. These are some of the issues which the FIRS needs to clarify in the implementation of the Finance Act.

In determining whether a person meets the above threshold, the value of the following taxable supplies shall be excluded: (a) a taxable supply of a capital asset of the person; and (b) a taxable supply made solely as a consequence of the person selling the whole or a part of its business or permanently ceasing to carry on business.

### *Timeline to File Returns/Remit VAT*

With regard to the timeline for filing VAT returns, the Finance Act now imposes an obligation on a taxable person who has made taxable supplies, or expects to make taxable supplies, that is over ₦25,000,000 to file VAT returns to the FIRS on or before the 21<sup>st</sup> day of every month in which the threshold is achieved and on or before the same day in the successive months thereafter. What this means is that any taxpayer that meets the threshold for VAT filing has an obligation to file VAT returns on or before the 21<sup>st</sup> day of the month in which it meets (or expects to meet) the threshold and subsequently file its VAT returns for every month thereafter.

### *Beware of Penalties!*

To enforce VAT compliance, the Finance Act has introduced stricter penalties for non-compliance with the provisions of the VAT Act. For instance, the Finance Act has increased the penalty for non-

compliance with the obligation to register, remit, issue tax invoice and collect VAT from =N=10,000.00 for the first month of default and =N=5,000 for each subsequent month of default to =N=50,000.00 and =N=25,000.00 respectively. In addition, as against the previous penalty of =N=5,000.00, a failure to notify the FIRS of a change of address or permanent cessation of trade or business within 30 days now attracts a fine of =N=50,000.00 for the first month of default and =N=25,000.00 for each subsequent month of default. Furthermore, the penalty for non-remittance of VAT has also been increased from 5% of the unremitted tax to 10% of the unremitted tax.

Business and consumers should, therefore, be conscious of these penalties and develop mechanisms for discharging their VAT compliance obligations to avoid the FIRS imposing the applicable penalties on them.

*This update is for general information purposes only and does not constitute legal advice. If you have any questions or require any assistance or clarification on how the Notice would apply to you or your business or require tax advice on any aspect of the Nigerian tax laws, please contact [taxteam@uubo.org](mailto:taxteam@uubo.org).*



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