'Why Are You Charging Us VAT?'

'Taxspectives' by **Afolabi Elebiju** | Originally published in *ThisDay Lawyer, 24th January 2012, p.14*

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Introduction

It is not uncommon for non-resident clients to ask their Nigerian advisers the above question, presumably because VAT should not be charged on the Nigerian firm's invoice since such services are 'exports.' This question becomes poignant when the same client respectively receives VAT and non-VAT invoices from Nigerian advisers on the same transaction. Expectedly, some clients would engage with their advisers who charge VAT to understand the rationale for such treatment. The 5% VAT could be substantial; and most likely irrecoverable because there is no output VAT against which the non-resident could set off the (input) VAT it had been charged.

Some clients (sometimes reluctantly) would let the matter pass once they accept the explanation that they had to pay VAT on Nigerian invoices, being 'consoled' that at least not all their Nigerian advisers are charging them VAT. Other clients may be more aggressive in their views that VAT is not applicable; where they had been previously charged VAT, they may go as far as asking that adjustments be made for VAT charged on previous invoices and, maybe give them refund or grant them credit against further billings. In this 'exported services VAT controversy', divergent VAT billing by Nigerian firms (and their risk management strategy), the views of the Revenue, conflicting interpretation of the *2007 VAT (Amendment) Act*, and absence of apposite Nigerian case law has provided ammunition for different positions taken on the issue.

Statutory Framework

Upon its enactment in 1993, the *VAT Act (VATA)* merely listed "exported services" in Part II of its 1st Schedule under "services exempt": there was no statutory definition of exported services. However, *section 12 VAT (Amendment) Act 2007 (VATAA)* seemingly cured the omission by defining "exported services" to mean "*service performed by a Nigerian resident or a Nigerian company to a person outside Nigeria.*" By *sections 3* and *13(b) VATAA* provision that "*goods and services listed under Part III of the First Schedule … shall be taxed at zero rate*" and creation of a new *Part III* which lists "*non-oil exports*" respectively, exported services have transmuted from VAT exempt to zero rated VAT treatment. By way of explanation, zero-rating means that the relevant item is a taxable supply but VAT is not charged because of the 0% VAT rate, whereas VAT exempt items are not taxable supplies, and therefore any input VAT incurred thereon cannot be recovered.

The question then arises: what impact if any, do the *VATAA* amendments have on VAT invoicing for exported services? This is the crux of this piece which, looks at pro and con arguments, pre and post VATAA provisions, and concludes that judicial clarification is required.

Pre-VATA Amendment

As noted previously, there was no definition of exported services prior to 2007. The FIRS took the view that services are not 'exported' just because the client is non-resident. If for example, it relates to a transaction or proposed transaction in Nigeria, the services will be considered as consumed in Nigeria and therefore VATable. I personally identified with the creative bent underlying this aggressive approach by the FIRS. Thus, if you are non-resident but receiving due diligence advisory services on a Nigerian target, for the purpose of VAT, it is reasonable to disregard residency. Prior to 2007, many clients were happy with the explanation that they would be charged VAT because the service was effectively consumed in Nigeria, even though they are non-resident.

Post VATAA provisions: Conflicting Interpretations

As noted, *section 12 VATAA* amendment to *section 46 VATA* defines exported services as "*any service performed by a Nigerian resident or a Nigerian company to a person outside Nigeria.*" Interestingly, two opposing interpretations on applicability of VAT have been ascribed to the definition. Some erudite colleagues that I have had benefit of their views on this issue believe that "*the major reason for the conflicting interpretations is the absence of appropriate punctuation marks in the definition.*"

According to them, "*the first interpretation is that 'exported service' means 'any service performed by a Nigerian resident or company toa person, outside Nigeria.' In essence, the term 'outside' relates to the location where the service is provided and not to the location of the recipient of such services. Thus 'exported services' only applies to services provided by a Nigerian resident outside Nigeria. The second interpretation is that the phrase means 'any service performed (by a Nigerian resident or company) to a person outside Nigeria. Therefore, the term exported services applies to all services provided by Nigerian residents*

to non-residents…. This position aligns with international best practices, though there are exceptions in some countries. It is also our view that this position represents a better interpretation of the ambiguous definition compared to the first."

Apparently, the first interpretation is the one preferred by the FIRS: for the transaction to qualify as export and therefore zero rated, the Nigerian resident must have rendered the service outside Nigeria. Could it be that the FIRS is bolstered in its view, because imported service is obversely defined as meaning *"service rendered in Nigeria by non-resident person to a person inside Nigeria"?* Because there is no caselaw on this point yet, the Revenue has been enforcing its position in its tax regulatory functions with taxpayers. Apparently, the absence of challenge is why there has not yet been a tax appeal (judicial) decision on the point.

Furthermore, taxpayers may not consider it worthwhile to appeal against FIRS position when they could seek to recover the hitherto 'unbilled' VAT from their clients. However, failure to charge VAT exposes supplier to 50% penalty on conviction *(section 29 VATA)*, and maybe the rigour of *section 32 FIRS Act* (10% addition for non-payment of tax and interest at CBN's MPR rate), although in the strict sense, *section 32 FIRS Act* should only apply to non-remittance of VAT received, not to unbilled VAT which is addressed by *section 29 VATA*.

I agree with my colleagues that post *VATAA*, the Revenue position is no longer tenable as the sole requirement is that the client is "outside Nigeria." My own explanation is that the since the earlier part of the provision refers to *"a Nigerian resident or a Nigerian company"*, the concluding part viz, *"to a person outside Nigeria"* can only be referring to the recipient of the service being non-resident, and not that the Nigerian resident or company is providing the service outside Nigeria! That is the reasonable interpretation that the literal rule impels us to apply: construe the words used in their ordinary meaning, unless an absurd result will ensue. If a Nigerian resident provides services to a client in Nigeria whilst temporarily abroad, and then bills upon arrival in Nigeria, won't VAT apply? My unhesitant answer is yes. My discussions reveal that the preponderance of opinion is that the FIRS' view is erroneous.

If we use the products analogy, Nigeria crude is exported because it is delivered to buyers outside our shores. Export could be both a noun and a verb. *Blacks Law Dictionary (8th ed.)* defines "export" in the latter sense variously as: *"to send or carry abroad"; "to send, take, or carry (a good or commodity) out of the country: to transport (merchandise) from one country to another in the course of trade."* "Exportation" is *"the act of sending or carrying goods and merchandise from one country to another."* In *Muller v Baldwin L.R.9 Q.B.457*, *"exported"* was held to mean *"carried out."* So it makes sense to construe the "exported service" as rendered in Nigeria by a Nigerian resident to a non-resident.

Risk Management Approaches

In the absence of Nigerian judicial interpretation of "exported services", taxpayers' response would be largely driven by their by their risk management strategy. A "low risk option" is to continue charging VAT to non-resident clients. If they insist that VAT is inapplicable and therefore refuse to pay, it would be prescient to get documentation to that effect which could act as "cover" for the Nigerian adviser in the event that FIRS' position is upheld as correct. Being "VAT collection agent" that can only remit VAT paid by clients, the Nigerian adviser would have done all that is statutorily required of it by billing the VAT. If the client sets-off previous VAT payments against subsequent receivables payable by it, the adviser can also set this off against future VAT remittance to the FIRS.

A "high risk option" is to agree with the client's position and discontinue billing VAT in subsequent invoices, with attendant exposure to liability if FIRS's position is judicially approved. This option may be compelling in competitive bidding situations (even the client may be under competitive pressure to maximize its position if the VAT numbers are significant), but it would be up to the adviser to decide whether engagement on such terms, is worth the risk. Again, if the client recovers VAT it had previously paid from subsequent payments to the Nigerian adviser, the latter should also be able recover same from future VAT remittances. The applicable penalty *(section 29 VATA)* is 50% of the invoice amount for failure to charge VAT on VATable transactions.

Conclusion

In view of the uncertainty, coupled with the pressure from non-residents that Nigerian advisers review their current VAT billing practices in the light of the *VATAA*, one hopes that the issue will come before the courts for resolution very soon. Seeking FIRS' ruling is not helpful because their views are already known (and the taxpayer may be of the school that believes FIRS is wrong). Secondly, FIRS rulings have been held not to have the force of law. Pending judicial determination, it would be prudent to adopt the low risk option. The variant where an insistent non-resident client is billed VAT, but documents its refusal to pay would seem to be a win-win solution in the circumstances, pending judicial resolution of the exported services VAT controversy.[1]

[1]Note: I am eternally indebted to my colleagues, whose thoughts added value to this article.