The Tax Appeal Tribunal ("the Tribunal") Ruling on Treatment of Rental Income as Taxable Income for Value Added Tax

REVIEW NOTES

Introduction:

The Tax Appeal Tribunal ("the Tribunal") on Thursday the 10th September 2020 delivered its ruling on the treatment of rental income as taxable income for Value Added Tax. This briefing examines the ruling and its likely implication on the Finance Act 2019.

Case Overview:

The Appellant (Essay Holdings) in this case approached the Tribunal to set aside the vat liability imposed on it by the Respondent (FIRS) over income generated from commercial rent. In resolving this dispute, the two following issues were considered by the Tribunal:

1. Whether rental incomes are subject to Value Added Tax (VAT) under the Value Added Tax Act CAP V1 LFN 2004 (as amended – VAT Act);

2. Whether the provisions of the Federal Inland Revenue Service Information Circular No 9701 dated 1st of January 1997 is not ultra vires the Respondent?

Respondent's Arguments:

The Respondent argued that only the goods and services listed in the First Schedule to the Act are subject to exemptions from VAT, and since commercial real income is not so expressed in the Schedule, it does not enjoy this exemption.

The Respondent contended that the FIRS circular of 1st January 1997 was made under the powers of the Finance Minister to amend the rates and schedules to the Act as provided by section 38 of the VAT Act. He also referred the Tribunal to section 44 of the VAT Act which in its view, empowers the Minister to donate such power to the Respondent. The information circular and its amendment (issued in 2018) were made in exercise of these provisions and should be viewed as a subsidiary legislation having the force of law.

Appellant's Arguments:

The main thrust of the Appellant's arguments was that commercial real income does not constitute the supply of goods and the rendering of service and

therefore do not come within the purview of the VAT Act.

The Applicant drew the Tribunal's attention to the legal principle positing that taxes can only be imposed on a person by tax legislations. Therefore, VAT can only be administered by the VAT Act, and not information circulars. He also argued that the only way rental income can be subjected to VAT is if the VAT Act was amended to expressly incorporate same. This process cannot be replaced by the information circulars used by the Respondent.

Tribunal's Key Decision Points:

The Tribunal established that anything considered a "good" for VAT purposes must be moveable or where affixed on land, must be severable from the land. It regarded services as an intangible commodity in the form of skill, effort or advice. In its opinion, land not being moveable or severable, could not be considered a "good" under the VAT Act. In its view, leases are a separate form of arrangement from services as the nature of interest passed in the lease transaction is not an intangible commodity described under services rendered, but the transfer of exclusive possession of the property to the tenant with the landlord retaining only a reversionary interest in the property.

On the second issue, the Tribunal re-echoed the principle espoused in **Halliburton v FBIR** on the status of circulars stating that the FIRS Information Circular in contention is neither law nor regulation but merely information to the general public and in particular all taxpayers' representatives, advisers and the staff of revenue services.

The Tribunal also called in aid the authority in **Warm Spring Waters and Ors v. FIRS** to reiterate the point that FIRS circulars cannot vary or amend the provisions of the VAT Act, modify the list of the exempted items in the First Schedule to the Act.

Accordingly, the FIRS efforts to amend the Schedule to the VAT Act, or alter its provisions vide the information circular were held to be inconsistent with the recognised process for such amendments.

On the whole, both issues were resolved in favour of the Appellant and the VAT liability assessment together with the interest and penalties were set aside.

Comments:

The Tribunal considered and answered the question of whether lease transactions could be considered a supply of goods or services and be treated to VAT in the negative. Lease transactions are distinct from transactions for the supply of goods and services and accordingly, do not come under the contemplation of the VAT Act.

Per the Ruling, the Tribunal reaffirmed the position of several preceding judgments which put circulars issued by the FIRS (and by extension, other government organisations) in their place. Circulars cannot alter or amend the specific provisions of tax law.

It must be noted here that this Ruling was decided on the VAT legislation preceding the amending effects of the Finance Act. It, therefore, did not consider the provisions of the Finance Act in resolving the issues raised in this dispute. It is therefore incumbent to consider the impact of the Finance Act on this Ruling.

Finance Act Considerations:

The significant introductions by the Finance Act of 2019 to the VAT Act include the increment of VAT rate, registration for VAT purposes, the increment of penalty for non-charging and non-remittance of VAT amongst others. The Finance Act also attempted to address the controversy that trailed the absence of a definition for goods and services in the VAT Act by introducing a definition for goods and services into the VAT Act. In section 46 of both Acts, goods mean

(b) any intangible product, asset or property over which a person has ownership or rights, or from which he derives benefit, and which can be transferred from one person to another, ***excluding interest in land.***

"Services" was defined to mean *"anything other than goods, money or security which is supplied excluding services provided under a contract of employment."*

In our view, these definitions do not apply to lease transactions in that all interest in land (including leasehold interests) is excluded by the express provisions of the definition of goods under the Finance Act.

In addition, the Finance Act introduced the term 'taxable supplies' into the VAT Act. This term is defined as *"any transaction for the **sale of goods** or performance of services for money's or money's worth."* Leasehold interests (as established earlier in this briefing) do not qualify as transactions for sale of goods or performance of services and therefore cannot be considered a taxable supply under this new introduction.

The specific exclusion of real property as goods under the Finance Act appear deliberate. The amendment of the VAT Act by the Finance Act derail the narrative above. This Ruling, therefore, remains good law.

Conflicting Decisions of the Tax Appeal Tribunal

In a ruling delivered by the Benin Zone of the Tax Appeal Tribunal on the 9th of September 2020 between *Chief J. W Elijah and Sons Company Limited v. FIRS* on an identical issue, commercial leases were held to be vatable as that Tribunal held that land was contemplated within the meaning of 'supply of goods' in the VAT Act. The Tribunal also relied on the Circular of 1st January 1997 and held that it would be inconsistent for taxpayers accept the exemptions on residential rent, and reject the imposition of VAT on commercial rent on the basis that it was not exempt in the Act. Several problems arise from this interpretation one of which is the tacit acknowledgment of the 'authority' of tax administrators to make and amend tax laws through circulars, a practice clearly not recognised in our legal jurisprudence.

Conclusions:

With the conflicting rulings of the Tax Appeal Tribunal in ***Elijah*** and ***Essay*** cases (both delivered on the 9th and 10th of September 2020 respectively), the ultimate answer to this lingering question continues to elude tax stakeholders, at least from a judicial standpoint. Stakeholders must therefore wait a little longer for judicial statements from appellate courts to seek guidance on the treatment of commercial rent income to VAT. Nonetheless, it is our considered view that notwithstanding the appellate courts' pronouncement on this matter, the amending effect of the Finance Act has rendered ***Elijah's ruling*** an academic exercise for future VAT treatment purposes. It is our opinion that ***Essays' ruling*** better addresses the question raised in this briefing and provides the much-needed clarity on the treatment of lease agreements to VAT. We believe that the definition of goods now incorporated in the VAT Act (as amended by the Finance Act) has to the extent that it has excluded interest in land, resolved this issue for good. To conclude, in ascertaining whether a transaction is vatable, one must consider how the item which is exchanged for money, or money's worth is classified within the definition of goods and services in the VAT Act (as amended).

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