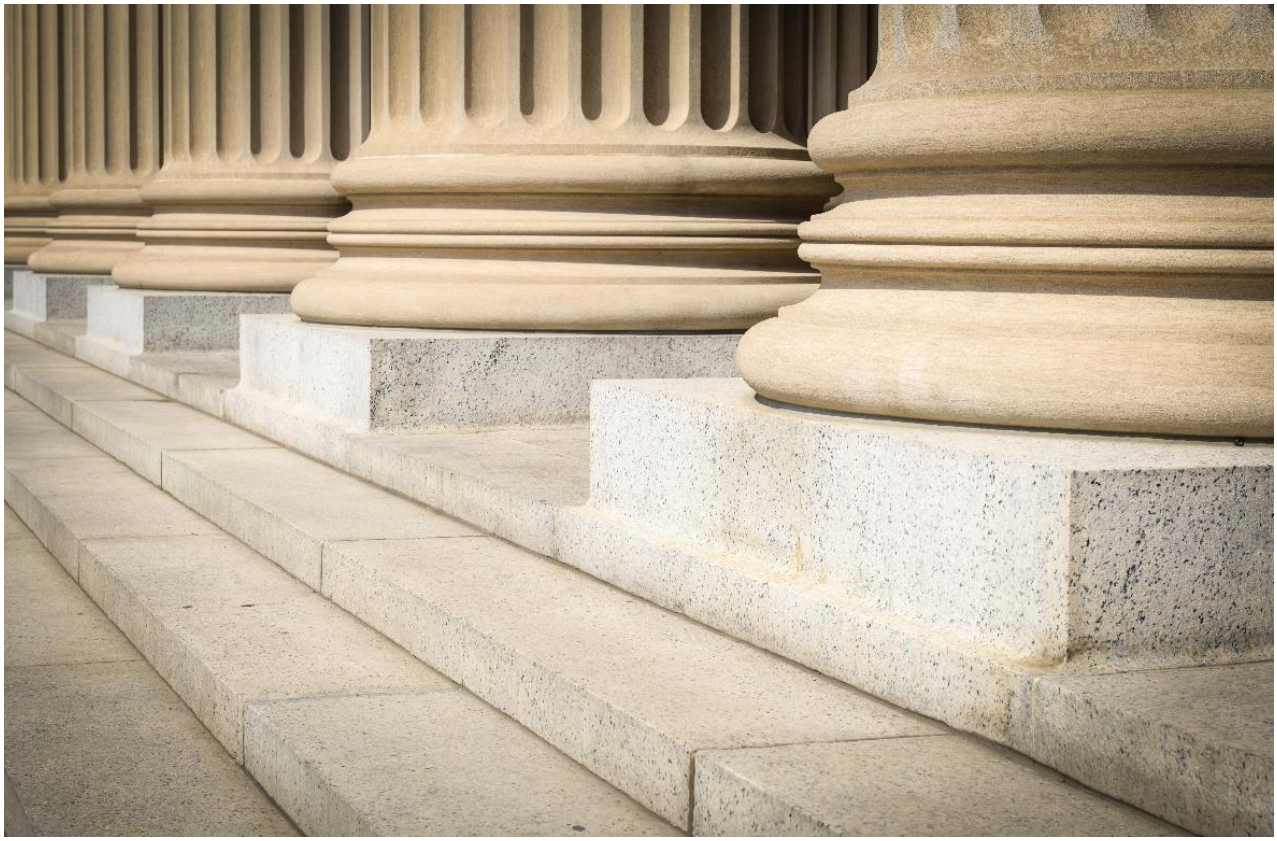

TAT provides clarification on value added tax and withholding tax implications of reimbursable expenses

The Tax Appeal Tribunal (TAT), on 2 June 2016, delivered a ruling on the applicability of value added tax (VAT) and withholding tax (WHT) on reimbursable expenses in the case between Brasoil Oil Services Company (Nigeria) Limited (Brasoil or the Company) and Federal Inland Revenue Service (FIRS). Other issues considered in the case include the applicability of WHT on extraterritorial income and the liability of taxpayers to interest and penalties on additional assessments, after validly objecting to FIRS' assessments and subsequently filing appeal to contest such assessments.

In delivering its ruling, TAT held that Brasoil was under obligation to deduct VAT and WHT on the contract sum of its Technical Service Agreement (TSA) with its parent company, Petrobras SA (Petrobras), with the exception of the reimbursable expenses.

Background of the case

The Company, a member of an international group of companies, is involved in the provision of services in all areas of the oil industry. The Company signed a TSA with Petrobras for the provision of technical support covering the period 2006 to 2012. As consideration for the support provided, Petrobras invoiced Brasoil for reimbursable expenses incurred on behalf of the Company plus a mark-up of 12% in line with the terms of the TSA.

FIRS conducted a tax audit exercise on Petrobtras' records in November 2013, and assessed the Company to VAT and WHT on the technical service cost incurred by it in the above period totalling US$4,860,927 and comprising:

- Reimbursable expenditure (travel costs, accommodation, feeding etc.)
- Income paid to employees on secondment from Petrobras SA
- Mark-up computed at 12% of the income paid to employees

… TAT's ruling regarding the non-applicability of penalty and interest on VAT and WHT liabilities established during audit/investigation exercise, has clearly raised more questions than answers.

Brasoil was dissatisfied with the additional tax assessment and objected. FIRS however issued a Notice of Refusal to Amend/Revise the Assessment and an appeal was subsequently made to the TAT by the Company.

Highlights of the ruling

In view of the issues submitted for evaluation, the TAT ruled as follows:

- Salaries and other reimbursable expenses are not subject to VAT and WHT. However, for the purpose of the TSA between the Company and Petrobras, the salaries paid to employee on secondment were considered to be part of the cost of rendering the technical service, as these were not specifically listed as expenses to be reimbursed in the TSA

- In as much as the Company confirmed that it was liable to deduct WHT (on the 12% mark-up), and remit same to FIRS, the argument would not stand. Therefore, the transaction is subject to both VAT and WHT

- Interest and penalties were not yet due on the disputed assessment, in line with the decision in the case of ***Weatherford Services vs. FIRS***[1]. FIRS was therefore urged to review its assessment in line with TAT's ruling

Take away

1. ***Cost plus arrangement and clarity around reimbursable***

   The cost plus invoicing arrangement has become a common practice among companies in recent times. While the pricing mechanism might be considered acceptable, the tax consideration of this arrangement has been considered to be a grey area, especially during tax audit/investigation exercise. The general understanding among taxpayers is that WHT and VAT would only apply to the mark-up element (service fee, service charge, commission etc.) and not the reimbursable costs, provided the vendor is able to present the relevant third party invoices/support documents in respect of the reimbursable costs. This practice is also reinforced by the fact that FIRS usually request that the relevant third party documents in respect of the reimbursable expenses be provided by taxpayers during tax audits.

   The above practice has been given credence by this decision; albeit, it demonstrates that the inapplicability of VAT and WHT to reimbursable expenses goes beyond mere provision of third party invoices or documentation. Therefore, it has become imperative for the parties to ensure that their understanding of what constitutes reimbursable expenses are stated in clear terms in the relevant contracts.

2. ***Applicability of penalty and interest on additional VAT and WHT assessments***

   The earlier decision in ***Weatherford vs. FIRS*** was in respect of an appeal concerning additional companies' income tax assessment. By this current ruling, the TAT has technically expanded applicability of this principle to cover VAT and WHT assessment, contrary to the provisions of the FIRS Establishment Act. It is

[1] TAT/L/013/2014

however yet to be seen whether this recent TAT ruling on the applicability of penalty and interest on outstanding VAT and WHT liabilities would stand the test of time.

Conclusion

This TAT ruling is a welcome development, as it provides further clarity on the application of VAT and WHT on reimbursable expenses. As such, it is imperative for taxpayers to take note of the principles established in this case with respect to reimbursable items and ensure that they are clearly stated in their contracts.

However, the TAT's ruling regarding the non-applicability of penalty and interest on VAT and WHT liabilities established during audit/investigation exercise, has clearly raised more questions than answers. It is a known fact that the relevant provisions of the law clearly stipulate the applicable penalties and interest in the event that VAT and WHT are not remitted as at when due. The decision of the TAT may be correct for CIT liabilities, but the extension of same to cover VAT and WHT assessment may be contested by FIRS.

This is because it will not be consistent with the provisions of the law on VAT and WHT. Should FIRS fail to appeal this decision, this ruling may represent the law until set aside by a superior court.

We therefore admonish taxpayers to continue to ensure that VAT and WHT are remitted to FIRS within the stipulated statutory deadline to avoid exposure to penalties and interest on the sum unremitted/remitted late.

Contacts:

Oluseye Arowolo
Partner, Tax & Regulatory Services
Mobile: +234 817 458 6604

Email: oarowolo@deloitte.com.ng

Yomi Olugbenro
Partner, Tax & Regulatory Services
Mobile: +234 805 209 0545

Email: yolugbenro@deloitte.com.ng

Patrick Nzeh
Partner, Tax & Regulatory Services
Mobile: +234 805 209 0483

Email: pnzeh@deloitte.com.ng

October 2016