The Court of Appeal judgement on the taxation of an educational institution in Nigeria

KPMG in Nigeria

February 2019

The Court of Appeal (COA) in its judgement delivered on 11 December 2018 upheld the judgement of the Federal High Court (FHC) in *Best Children International Schools Limited ("BCISL" or "the Appellant") vs Federal Inland Revenue Service ("FIRS" or "the Respondent")* to the effect that BCISL, not being a company limited by guarantee, was liable to Companies Income Tax (CIT).

Facts of the case and issues for determination

BCISL is a company limited by shares and provides primary and secondary educational services in Nigeria. The company did not pay CIT liabilities for 2008 – 2012 tax years on the basis that its educational activities are exempt from income tax under Section 23(1)(c) of the CIT Act (CITA). The Company in April 2013 received a confirmation from the FIRS through its National Association, that its profits from educational activities were exempted from CIT so long as such profits were not derived from a trade or business carried out by the Company.

However, the FIRS assessed the Appellant to income tax for 2008 to 2012 tax years in September 2014 on the ground that BCISL did not qualify for the exemption conferred by Section 23(1)(c) of CITA, which provides as follows:

23(1) "*There shall be exempt from tax – (c) the profits of any company engaged in ecclesiastical, charitable or educational activities of a public character in so far as such profits are not derived from a trade or business carried on by such company*".

Consequently, BCISL instituted a lawsuit against the FIRS at the FHC and sought an order to prohibit the FIRS from enforcing its demand notice on the Company, and an injunctive order to restrain the FIRS, its staff, privies or its agents from further imposition of income tax on the Appellant.

The FHC delivered judgement in favour of the FIRS on the grounds that:

(a) the exemption granted under Section 23(1)(c) of CITA only applies to companies that are limited by guarantee under Section 26 of the Companies and Allied Matters Act (CAMA), which provides as follows:

26(1) "*where a company is to be formed for promoting commerce, art, science, religion, sports, culture, education, research, charity or other similar objects, and the income and property of the company are to be applied solely towards the promotion of its objects and no portion thereof is to be paid or transferred directly or indirectly to the members of the company except as permitted by the Act, the company shall not be registered as a company limited by shares, but be registered as a company limited by guarantee*"

(b) BCISL is a company registered as a profit-making venture, and was not registered as an educational institution of public character by virtue of its incorporation as a company limited by shares under CAMA.

Dissatisfied with the FHC's decision, BCISL filed an appeal at the COA, seeking the determination of the following issues:

1. Whether the FHC erred in the construction of Section 23(1)(c) of CITA by holding that the subsection only contemplates companies limited by guarantee under Section 26 of the CAMA.

2. Whether the FHC misdirected itself when it relied on the fact of the registration of BCISL as a private company limited by shares in determining whether the company falls under Section 23(1)(c) of CITA.

BCISL argued that it is a company registered under CAMA which runs and manages schools that are open to the public regardless of sex, religion and ethnicity, and does not carry on any other trade or business. The FIRS, on its own part, argued that the Company did not fulfil all the conditions provided in Section 23(1)(c) of CITA to merit such exemption.

> The Court went too far by requiring the Appellant to prove that it is an "institution of a public character" as this is not a requirement for eligibility for income tax exemption under Section 23(1)(c) of CITA. Any company engaged in educational activities that is claiming eligibility to tax exemption under the provision is only required to prove that its educational activities are of a pubic character. In other words, it is the activities of the company that must be of a public character, and not the company itself.

Bases of the Court's decision

After considering the arguments of both parties, the COA dismissed the appeal and entered judgement in favour of the FIRS on the following grounds:

(i) The fundamental distinctive characteristics or quality of a company are in its DNA or its make-up. This will be reached by how the company came into being and by which form of company it is. In this regard, the Appellant did not disclose that it was a company limited by guarantee.

(ii) BCISL did not prove that it was an academic institution or an institution of a public character or that it does not derive profit from a trade or business carried on by it.

(iii) BCISL is a company limited by shares and is thus a profit-making company, and as such, does not qualify for the exemption granted by Section 23(1)(c) of CITA.

Comments

Clearly, no court can help a litigant who did not establish his case. To this extent, in the absence of any proof before it, the judgement of the Court cannot be faulted that the Appellant did not establish that it was an "academic institution". This could have been proved through the certificate of incorporation and memorandum and articles of association of the company establishing both its corporate status and education as its main object.

However, the Court went too far by requiring the Appellant to prove that it is an "institution of a public character" as this is not a requirement for eligibility for income tax exemption under Section 23(1)(c) of CITA. Any company engaged in educational activities that is claiming eligibility to tax exemption under the provision is only required to prove that its educational activities are of a pubic character. In other words, it is the activities of the company that must be of a public character, and not the company itself. By wrongly focusing on "institution of a public character", the court missed the opportunity of examining and pronouncing on what would qualify as "educational activities of a public character" without which no company is entitled to claim tax exemption under Section 23(1)(c) of CITA. Doing this would have advanced the body of knowledge of Nigerian tax law beyond the decision of the Tax Appeal Tribunal in *American International School vs FIRS* (2015).

The Court also unduly strained the interpretation of a "company" in Section 23(1)(c) of CITA when it held that the company envisaged by that provision as eligible to enjoy income tax exemption is a company limited by guarantee registered under Section 26 of CAMA. However, Section 23(1)(c) refers to "any company" without any such limitation. To this extent, a company limited by shares engaged in educational activities is as entitled to income tax exemption as a company limited by guarantee similarly engaged in educational activities, as long as it can establish that its educational activities are of a public character. The reverse will also be true of a company limited by guarantee engaged in educational activities whose profits will not qualify for income tax exemption, if it cannot prove that its educational activities are of a public character. In essence, the fact that a company engaged in educational activities is a company limited by guarantee, will not necessarily guarantee its exemption from income tax if it cannot establish that its educational activities are of a public character.

Section 26 of CAMA did not make a company limited by guarantee the only vehicle for setting up a company engaged in educational activities of a public character. Rather, it is up to the promoters of a company intending to engage in educational activities of a public character to determine which vehicle they want to use, whether a company limited by shares (if they want to distribute its profits), or a company limited by guarantee (if they do not want to distribute its profits). Either way, for the chosen vehicle to enjoy income tax exemption, its educational activities must be of a public character. By providing income tax exemption for *"any company … engaging in educational activities of a public character"*, it means that the law does not frown at the profit motive of the investors in a company limited by shares investing in educational activities of a public character. Indeed, the law did not disguise its intention to exempt the profits of such a company from income tax.

The Court was unduly carried away by the commercial objective of a company limited by shares by virtue of which its profits are distributable to its shareholders in arriving at its decision that such a company is not entitled to income tax exemption. By the same token, it was overly influenced by the fact that the members of a company limited by guarantee engaged in educational activities are not driven by the expectation of profits in holding that such a company is tax-exempt. There is clearly no provision in the law to this effect.

Lastly, the Court made the point that a company engaged in educational activities must not be engaged in any trade or business to qualify for income tax exemption. Therefore, even if a company limited by shares is engaged in only educational activities of a public character, its profits will not be exempted under Section 23(1)(c) of CITA as it is engaged in a trade or business. But nothing could be further from the truth, and it is a clear instance of misinterpretation of the law. The correct position is that while Section 23(1)(c) of CITA exempts the profits of a company from its core activities (be it ecclesiastical, charitable or educational) of a public character, it does not provide a shield for its extraneous profits earned from sources outside its mission. It is unfortunate, indeed, that no reference was made to the case of *Revd Shodipo & 2 others vs FBIR* (1974) reported in 2010 3 TLRN 61 where this issue was authoritatively settled. In that case, it was held that the tax exemption granted to religious organizations by Section 23(1)(c) of CITA is limited to incomes from their religious pursuits, and that they would be liable to income tax on their profits from commercial ventures. In effect, a company (whether limited by shares or by guarantee) engaged in educational activities of a public character is liable to tax on income arising from trade or business that is not related to its educational activities of a public character. An example in this regard is where any such company rents out its school premises, or a part of it, such as its assembly hall or recreation facility, for public functions in return for a fee.

In conclusion, it must be noted that the Court of Appeal's decision would not have been different even if the Appellant had proved with appropriate documentation that it was an academic institution (to use the language of the Court). The Court's decision was more driven by the fact that the Appellant is not a company limited by guarantee which, in its judgement, is the only entity eligible for income tax exemption under Section 23(1)(c) of CITA

At this stage, the last hope for authoritative pronouncement on the issue of taxation of educational institutions is the Supreme Court. But in the event that the Appellant decides not to pursue its case to the apex court, it is up to any other company limited by shares engaged in educational activities of a public character that the FIRS assesses to income tax, to challenge the imposition with proper professional guidance and counsel.

For further enquiries on the above, please contact:
Wole Obayomi
NG-FMTAXEnquiries@ng.kpmg.com