The Federal Inland Revenue Service (FIRS) issued a Public Notice on 14 August 2019, directing taxpayers, particularly companies in the Fast-Moving Consumer Goods (FMCG) sector, to deduct and remit withholding tax (WHT) and value added tax (VAT) on “compensation” paid to their distributors, dealers and agents (collectively referred to as “Distributors”). The Public Notice defined compensation to include commission, rebates, etc., granted in any form, whether by way of cash, credit note or goods-in-trade.

According to the FIRS, the issuance of the Public Notice is in furtherance of the directive contained in the Companies Income Tax (Rates, etc. Deduction at Source (Withholding Tax) Regulations S.1 10 1997 (sic) and Paragraph 3.8 of its Information Circular No. 2006/02 of February 2006. The FIRS further indicated that it would soon commence monitoring taxpayers’ compliance with the directive and solicited the cooperation of all stakeholders in this regard.

Matters Arising

The FIRS’ continued drive to boost tax revenue by widening the tax net and eliciting voluntary tax compliance from taxpayers is justifiable. This is in view of the country’s relatively low tax-to-GDP ratio and the dire need for revenue to fund national and sub-national budgets. The Public Notice was therefore issued by the FIRS to block perceived WHT and VAT leakages in FMCG companies’ transactions with their Distributors.

However, the legal basis and practicality of certain aspects of the directive raise questions that should be addressed before further action. Thus, it may be necessary for the FIRS to revisit its position before enforcing the directive against the relevant taxpayers.

We have identified the two major challenges below:

1. **Basis for deduction of VAT at source**

   Under the Nigerian VAT regime, only three groups of taxpayers are obligated to deduct VAT at source and remit directly to the tax authority. These are:

   a. Nigerian companies that are carrying on VATable transactions with non-resident companies within the country;

   b. Government ministries, statutory bodies and other agencies of government; and

   c. Companies operating in the oil and gas sector.

   There is currently no statutory provision that requires or empowers the FIRS to require companies that do not fall into any of these three categories to deduct VAT at source from compensation paid to their Distributors. Thus, the FIRS may need to approach the National Assembly for amendment of the current VAT legislation before attempting to enforce the directive.

2. **Non-coverage by WHT Regulations, 1997**

   While the Regulations clearly requires companies to deduct and remit WHT on commissions at 10%, it did not include other forms of compensation, such as rebates, as qualifying transactions for WHT deduction purpose. A rebate is generally a form of trade incentive that is granted on fulfilment of certain conditions and includes, but not limited to, discounts, allowances and refunds. Therefore, its exclusion from the Regulations cannot be deemed to be an oversight as the arrangement is not a new development unknown at the time the Regulations was issued.

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In practice, also, the amount of rebate granted is not earned exclusively by the direct Distributors. It is usually shared with sub-Distributors along the distribution value chain. Indeed, in some instances, the final consumers may partake in it. Thus, since WHT is an advance payment of income tax, it may be counter-productive to expect the direct Distributors only to bear the burden of WHT deduction on an income that they may not eventually earn.

In light of the foregoing, the FIRS may need to revisit the directive and streamline it to reflect the provisions of the Regulations.

Conclusion

Given the above-mentioned challenges and the far-reaching implications of the Public Notice, the FIRS should consider engaging with the relevant stakeholders, particularly those in the FMCG sector, before further action. This will enable the FIRS to have a better understanding of the various types of compensation its directive seeks to cover, and develop a robust, pragmatic and efficient approach to addressing them. In the final analysis, achieving the FIRS’ objective will require a legislative action as the directive is outside the scope of the prevailing legislation and Regulations.

Meanwhile, companies affected by this directive are advised to review their business arrangements with their Distributors and ensure that they comply with the provisions of the current tax legislation and Regulations. This will enable them to reduce exposure to potential additional tax liabilities that may arise from any form of non-compliance with the valid provisions of the law.