

Exemption of sales in the ordinary course of business from WHT

KPMG in Nigeria

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Tax and Credits

The Tax Appeal Tribunal (TAT or “the Tribunal”) Lagos Zone on 30 November 2020 decided in *Tetra Pak West Africa Limited (Tetra Pak or “the Appellant”)* and *Federal Inland Revenue Service (FIRS or “the Respondent”)* that sales in the ordinary course of a company’s business are exempt from withholding tax (WHT) in line with the provisions of the WHT Regulations pursuant to the Companies Income Tax Act, C21, LFN, 2004 (as amended) (CITA).

Facts of the case

Tetra Pak’s principal business activity is the importation and sale of packaging equipment and spare parts to customers in the manufacturing sector. In July 2016, the Appellant wrote a letter to the FIRS seeking clarification on whether its principal business, *the sale of packaging equipment, spare parts and materials*, qualified as sales in the ordinary course of business and, therefore, exempt from WHT. The FIRS in its response letter of 18 December 2019 noted that *the sale of packaging equipment, spare parts and materials* is a contract with rights and liabilities enforceable by law and, therefore, did not qualify as sales in the ordinary course of business. The FIRS further noted that Tetra Pak’s sales were subject to WHT at the rate of 5% based on the provisions of its Information Circular No. 9801 of 1 October 1998.

Dissatisfied with the position of the FIRS, the Appellant appealed to the Tribunal, seeking the following reliefs, among others:

- i. a declaration that its *sale of packaging equipment, spare parts and materials* qualifies as sales in the ordinary course of business and is, therefore, exempt from WHT,
- ii. a declaration that the FIRS cannot amend the provisions of the CITA by its information circulars,
- iii. a dismissal of the FIRS’ letter dated 18 December 2019, wherein the FIRS stated that Tetra Pak’s business activity does not qualify as sales in the ordinary course of business; and

In response to the above grounds of appeal, the FIRS argued that the relevant provision of the WHT Regulations were ambiguous, and that an endorsement of the Appellant’s position would defeat the purpose of the WHT Regulations, and lead to loss of revenue to the government. The FIRS also posited that the intent of the legislators was to make WHT applicable to all types of contracts and agency agreements of which the Appellant’s business activity falls under, except for contracts of sale in the ordinary course of business. The FIRS therefore urged the Tribunal to resolve the issues in its favour.

Issues for determination

Based on the prayers and arguments submitted by both parties, the Tribunal formulated one key issue for determination, which was, *“Whether the Respondent was not wrong when it held that sales of packaging materials, spare parts, equipment and provision of installation, maintenance and repairs of equipment were not sales by the Appellant in the ordinary course of its business but contracts with rights and liabilities enforceable by law.”*

TAT’s decision

After considering the arguments of both parties, the TAT held that:

“Sales in the ordinary course of business” is a relative term which cannot be applied as a rule of thumb to all taxpayers without regard to their daily business realities. Based on the *Black’s Law Dictionary* definition, “ordinary course of business” means *“the normal routine in managing trade or business.”* In the absence of any local case law, the TAT reviewed judicial precedents in India and formulated the following questions to determine whether or not a sale is in the ordinary course of business of a company:

- Is the transaction comprising the sale of part of the main or ancillary objects of the taxpayer’s Memorandum and Articles of Association?
- What is the nature and practice of the taxpayer’s business industry?
- Does the taxpayer have a history in relation to the transaction?
- How often does the taxpayer engage in sale? is it a solitary transaction?

The Appellant’s business objects as stated in its Memorandum and Articles of Association include the sale of equipment and repairs. Therefore, Tetra Pak’s ordinary course of business is the purchase and sale of packaging materials, spare parts and equipment and is thereby exempted from WHT.

The TAT further noted that whether a sale is in the ordinary course of business is a question of fact, and the category of transactions that would amount to a sale in the ordinary course of business is not closed. Hence, the tax authority, must consider each taxpayer's case on its merits to ascertain whether the sale in question has any reasonable connection with the normal course of business of the taxpayer, and whether the intention of the taxpayer is to effect that sale in the course of its business.

Commentaries

The TAT has formulated a set of tests for determining whether a transaction constitutes a *sale in the ordinary course of business* and, therefore, eligible for WHT exemption. The TAT's position is that while all contracts and agency arrangements are liable to WHT, only sale transactions which are neither normal or routine with respect to the trade or business of the company under consideration should be subject to WHT. While the tests set out by the Tribunal may not be exhaustive, it provides a practical basis for a case-by-case evaluation of a company's sales transactions in relation to its business activity.

Nonetheless, most taxpayers in practice have maintained a conservative approach in accounting for WHT by withholding taxes on all transactions that ordinarily align with the routine or customary practice of their vendors. This has led to many companies having significant unutilised WHT credits with the FIRS. Although Sections 81(7) of CITA and 40 of the FIRS Establishment Act provide for the refund of such

excess WHT within ninety days after proper auditing by the FIRS of such claims, this process is usually arduous and discourages most taxpayers from seeking a refund.

The TAT's comment on the primary and secondary principles of the WHT regime is very instructive in the administration of WHT by the tax authorities. The primary objective should not be to optimise tax collection to the detriment of taxpayers, but to check tax evasion. In essence, the tax authorities should not look for ways to subject to WHT transactions that are otherwise exempted. This is not only to protect taxpayers' cashflow but to prevent a situation where the WHT deducted could result in a higher effective tax rate.

Finally, the TAT has again affirmed its position in accordance with several court judgments that the FIRS Circulars are mere administrative instruments expressing the FIRS' opinions on tax matters. Hence, they cannot be used as a tool to vary, amend or alter the provisions of the tax laws.

Conclusion

The TAT judgment is a step in the right direction, and it provides a legal basis for taxpayers to challenge the FIRS' practice of subjecting all sales to WHT without considering if they qualify as sales in the ordinary course of business. It is hoped that the FIRS will not be overly driven by the pressure to collect revenue but will be guided by this decision in its future administration of WHT in relation to sales in the ordinary course of business.

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