TAT's judgement on the tax deductibility of demurrage and other expenses

KPMG in Nigeria | September 2020

The Tax Appeal Tribunal (TAT or "the Tribunal") sitting in Lagos recently delivered judgement in the consolidated tax appeals between *Tetra Pak West Africa Limited (TetraPak or "the Appellant")* and the *Federal Inland Revenue Service (FIRS or "the Respondent")* on the tax deductibility of certain expenses and the applicability of interest and penalty on assessments under dispute.

Specifically, the dispute was whether expenses, such as demurrage, training and education expenses etc., incurred by the taxpayer are legitimate business expenses which were *wholly, reasonably, exclusively and necessarily (WREN)* incurred in generating the company's profits, and therefore, should be allowed for tax purposes.

Facts of the case

The Appellant filed its tax returns for 2011 year of assessment (YOA) in accordance with the provisions of Section 55 of the Companies Income Tax Act, Cap. C21 Laws of the Federation of Nigeria, 2004 (CITA). The tax returns show that the Appellant incurred tax loss for the year and, therefore, could not utilise its capital allowances. In 2014, the FIRS conducted a tax audit exercise on the Appellant's tax returns for 2008 to 2012 YOAs. During the audit exercise, FIRS came across an unsigned tax return which showed that TetraPak made profits in 2011 YOA. Consequently, the FIRS relied on the unsigned tax returns and disregarded the signed copies of the returns submitted by the Appellant which show a loss and unutilised capital allowances positions.

In addition, the FIRS disallowed the following expenses incurred by the Appellant namely - demurrage, school fees of dependents of expatriate staff, training and education expenses. Further, the FIRS disallowed the investment allowance claimed by the Appellant on computers. The FIRS based its position on a joint reading of Sections 24, 27, 32(1) & (2) and Second Schedule of CITA. The FIRS also imposed interest and penalty on the alleged additional tax liabilities in its notices of assessment.

The Appellant disagreed with the additional assessments and objected in writing within the statutory 30-day period, after which the Respondent issued its Notice of Refusal to Amend.

Issues for determination

Based on the prayers and arguments submitted by the parties, the Tribunal formulated the following two key issues for determination:

- whether the Respondent was right to disallow the items objected to by the Appellant; and
- whether the Respondent acted in accordance with the provisions of CITA by imposing penalties and interest on the Appellant.

TAT's decision

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

i. The tax returns filed by the Appellant, which was disregarded by the FIRS, complied with the requirements of Section 55(1)(a)(b) of CITA and should be the basis of assessing the tax position of the Appellant. Therefore, the loss and unutilised capital allowances stated in the tax returns should be available for the Appellant's use in its 2012 tax returns, as stipulated by Section 31(2) and Paragraph 24(2)(3) and (4) of the Second Schedule to CITA, respectively.

ii. Based on the provisions of TetraPak's Global Mobility Long Term Assignment Employee Handbook, TetraPak is obliged to pay the school fees of the dependents of its expatriate staff who are within a specified age category and, therefore, the expense is tax deductible.

iii. The expenses incurred by the Appellant for the training and education of its staff are vital to the production of its profit and should be allowed as tax deduction.

iv. In line with the *Black's Law Dictionary*, 8th Edition definition of the terms - "*plant*" and "*equipment*", computer does not qualify as the Appellant's plant and equipment and, therefore, should not qualify for investment allowance.

v. "*Demurrage*" is neither a fine nor penalty imposed by any statutory provision. Rather it is a business expense which should be subject to deductibility rule test. Further, the cost was incurred *WREN* for the operation of the Appellant's business and should, therefore, be allowed for tax purposes.

vi. A demand notice cannot on its own be taken as final and conclusive unless the taxpayer fails to object within the statutory timeline. As the Appellant objected to the assessments within the statutory timeline, the assessments were not final and conclusive and should not attract penalty and interest.

Comments

1. The issue of deductibility of demurrage has been an ongoing debate between taxpayers and the FIRS. The FIRS had long held that demurrage is a penalty paid as result of a company's failure to clear their goods from the port within a specified period and, therefore, an unnecessary expense for the generation of the company's profits. However, there is no provision of the tax laws that classifies demurrage as a penalty, or precludes it or similar payments under contractual obligation from being tax deductible. The TAT's pronouncement that demurrage is not a fine or penalty imposed pursuant to a statutory provision is very instructive in this instance. The fact that an expense or cost is described as penalty does not mean that it is not deductible for tax purposes. Hence, every expense or cost, aside those expressly allowed or disallowed in the CITA, must be subjected to the *WREN* test in order to ascertain their tax deductibility or otherwise.

   The resolution area of longstanding dispute between taxpayers and the FIRS will bring relief to taxpayers who have been twice 'penalized' by paying demurrage (to the shipping lines and or port authorities, as the case may be) which the FIRS denied them from applying as a tax deductible expense.

2. The TAT upheld that the dependents' school fees paid by the Appellant on behalf of the expatriates is a valid business expense which was incurred in line with the employment agreement with its staff. This is a notable reminder to taxpayers to ensure that staff entitlements are properly documented in Staff Handbook and/ or employment letters in order to avoid unnecessary contention with the tax authorities on their deductibility.

3. The TAT relied on the *Black's Law Dictionary's* definition of "*plant and equipment*" in deciding that the Appellant is ineligible to claim investment allowance on computer as it does not constitute part of its plant and equipment based on the Appellant's nature of business. Though the TAT failed to provide an instance where computers would constitute part of plant and equipment of a taxpayer. Most business operations are automated and uses computers in the direction and operation of various business processes. For instance, the International Financial Reporting Standards provides for use of various considerations in the classification of assets in the financial statements. Hence, computers may be classified as computer equipment or part of plant and equipment or furniture and fittings, depending on several considerations, including the purpose of use, useful life and value threshold limit. It is, therefore, important that clarification is provided regarding the context where computers will not qualify as plant and equipment to avoid a blanket application of the TAT judgement by the FIRS as a precedent on all computers.

4. The decision of the TAT on the non-applicability of penalty and interest on an assessment under dispute aligns with the provisions of Section 76 of CITA and Paragraph 13 of the Fifth Schedule to FIRS Establishment Act. The combined reading of these provisions confirms that the FIRS can only impose penalty and interest on additional tax liabilities where they become final and conclusive and the taxpayer fails to settle the assessment within the stipulated timeframe. The tax authorities should, therefore, align their approach and practices to the provisions of the tax laws and refrain from charging penalty and interest on disputed assessment notices.

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