Tax Appeal Tribunal Rules on Dis-allowable Expenses in Determination of Companies' Assessable Profits

TAX ALERT

Introduction

The Tax Appeal Tribunal, on 28 February 2020, delivered a judgment in the case of Tetra Pak West Africa Ltd ("Tetra Pak" or "the Appellant") against the Federal Inland Revenue Service (FIRS), pronouncing on the deductibility of expenses incurred by the Appellant towards payment of school fees of expatriate staff's dependents, costs of staff training and demurrage payments for delays in offloading its cargo at ports. Ruling in favour of the Appellants, the Tribunal relied on the application of the "Wholly, Reasonably, Exclusively and Necessarily" (WREN) test to determine the validity of the above costs being added back to the Appellant's profit for tax purpose.

The Finance Act 2019 provides that the Finance Minister may by order, determine what constitutes SEP in Nigeria. Consequently, the finance minister has issued an order with an effective date of 3 February 2020 to determine SEP.

Background

The FIRS, following a Tax audit exercise conducted in 2014 assessed the Appellant to additional Companies Income Tax (CIT) and Education Tax (EDT) for the 2011 and 2012 Years of Assessment (YOA). According to the FIRS' assessment, the costs incurred by Tetra Pak in favour of School fees payments for Staff's dependents, staff training and demurrage payments did not qualify as costs incurred wholly, reasonably, exclusively and necessarily for the generation of the Appellant's profits under s. 24 of the Companies Income Tax Act C21 LFN 2004 (CITA).

The Appellant was dissatisfied with this assessment and filed an appeal at the Tax Appeal Tribunal.

The FIRS argued, in support of its position, that costs incurred for payment of school fees, termed as "other employee remuneration" failed to satisfy s. 24(d) CITA which makes provisions for quantum of benefit or allowance accruable to an employee that would qualify as an allowable deduction from assessable profit. The FIRS also argued that the costs incurred for training of staff did not qualify as an allowable deduction on the basis that the training was provided by a related company and it did not satisfy the WREN test. A similar argument was submitted by the FIRS on the issue of demurrage payments, it contended demurrage payments are of a punitive nature and should not be deemed to satisfy the WREN test for purpose of CIT and EDT assessment. FIRS prayed the Tribunal to dismiss the appeal and uphold its additional assessment.

Tetra Pak, on the other hand, argued that all the expenses, on which the FIRS based its additional assessment, were incurred in full satisfaction of the WREN test. The Appellant tendered in evidence its Staff Handbook in support of its claim that school fees costs were part of "other employee remuneration". It also argued that the fact that the Staff training was carried out by related entity did not disqualify the costs incurred for deduction as staff training plays a direct role in generation of the Appellant's revenue. On the issue of demurrage, the Appellant argued that the costs incurred in that

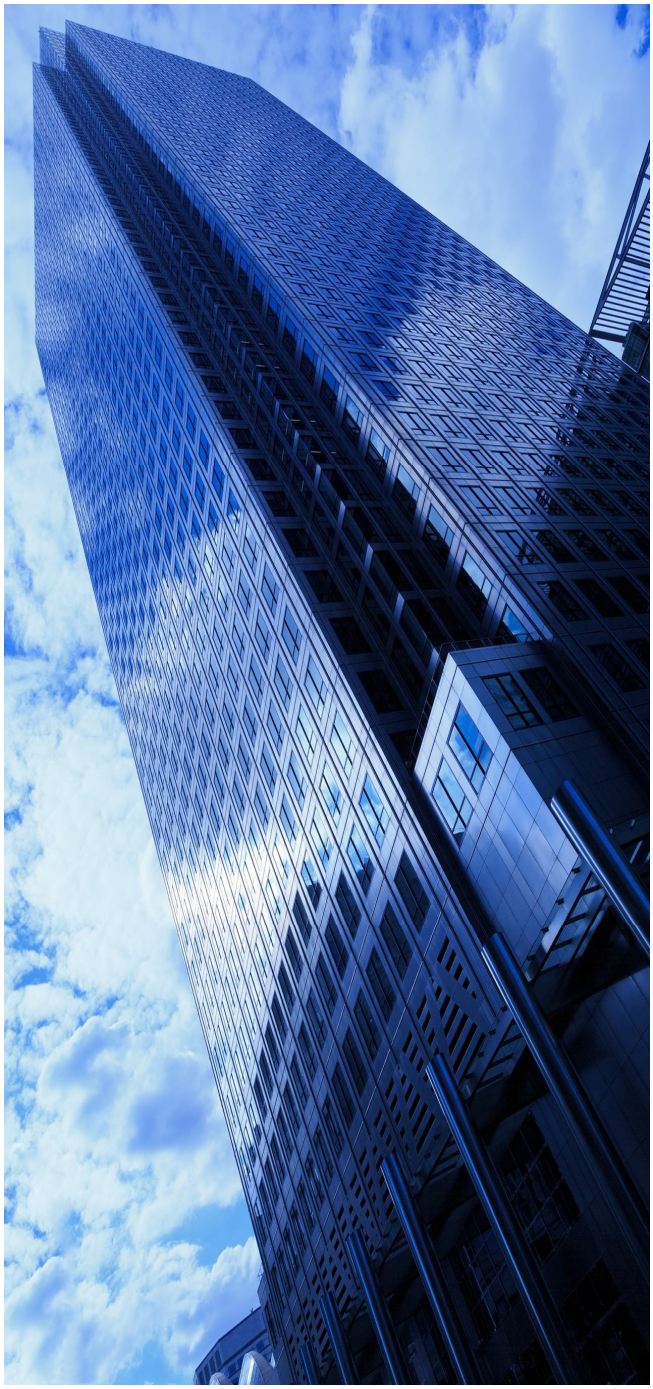
regard were quite necessary, given that the circumstances that gave rise to the payments were out of its control; it tendered evidence to this effect, showing the Tribunal that demurrage payments are essentially unavoidable owing to factors like bureaucracy and congestion at the ports.

The Tribunal, in a well-considered ruling, accepted the Appellant's submissions and ruled in its favour, dismissing the FIRS' additional assessments to CIT and EDT. The Tribunal concluded that the school fees of employees' defendant were indeed deductible on the strength of the evidence tendered by the Appellant to show that they formed part of employee remuneration and were necessary for the company to make profit. It also held that training of staff is vital to the production of a Company's profits and ruled that the staff training costs were allowable deductions. Finally, the Tribunal agreed with the Appellant's arguments on the issue of demurrage, classifying the cost not as a fine or penalty, but a necessary business expense for the Appellant. The Tribunal upheld the Appellant's appeal and dismissed the FIRS' additional assessments as null and void.

Our Comments

The Tribunal's decision in the case is a commendable one because the Tribunal took the time to examine the peculiar circumstances of the case before delivering its judgment. Quite importantly, the Tribunal ruled on the controversial issue of demurrage payments, emphasizing that the nature of demurrage is not one of a punitive nature, as it is not imposed pursuant to some contravention of statutory provision, but of a contractual nature between contracting parties and must be treated as a business expense for this reason. The Tribunal also pointed out that the demurrage costs were showed to be unavoidable due to infrastructural challenges by the Appellant, an important consideration in determining which costs satisfy the WREN test. The Tribunal added that if the FIRS had been able to prove that the costs were avoidable, it would have been inclined to grant judgment in the FIRS' favour.

The Tribunal highlighted, with this judgment, the distinction that must be used in the fair and equitable application of the WREN test on taxpayers' expenses. It is also worthy of note that the Finance Act 2020 has amended section 27 CITA to include as a non-allowable deduction "any penalty prescribed by any Act of the National Assembly for violation of any statute", further buttressing the contention that a cost cannot be termed as a penalty at the mere behest of a tax authority without some statutory provision prescribing it as such. Taxpayers are advised to take into account and apply the jurisprudence in the Tribunal's decision to their tax planning activities going forward to avoid liability.



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