

TAT rules that the discretionary powers of FIRS on declaration of deemed dividend cannot be challenged

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The Lagos zone of the Tax Appeal Tribunal (TAT) has ruled, in the case involving Rand Merchant Bank Nigeria Limited (*Rand or “the Company” or “the Appellant”*) and Federal Inland Revenue Service (FIRS or “the Respondent”), that the FIRS’ discretionary powers under section 21 of the Companies Income Tax Act, as amended, cannot be challenged.

Background of the Case

The Respondent assessed the Company to additional Withholding Tax (WHT) liability (on its undistributed profits) of **₦602,590,813.53** (Six Hundred and Two Million, Five Hundred and Ninety Thousand, Eight Hundred and Thirteen Naira, Fifty-Three Kobo) inclusive of interest and penalty for the 2017 financial year.

Despite the Company’s objection, the Respondent issued a Notice of Refusal to Amend (NORA), indicating its refusal to discharge the additional liabilities. Dissatisfied with this decision, Rand filed an Appeal before the TAT, seeking to have the liabilities set aside.

Appellant’s Argument

The Company raised two issues for determination in making its argument. The Appellant submitted that, under section 21 of the Companies Income Tax Act (CITA), the powers of the FIRS to treat undistributed profits of a company as distributed and impose tax on the deemed dividends of the shareholders were not absolute as they were subject to the following conditions:

- If the purpose of the decision to not distribute the profits was to reduce the aggregate of the tax chargeable in Nigeria on the profits or income of the company and the controlling shareholders; and

- If the profits could have been distributed without detriment to the Company’s business.

Regarding the first condition, the Appellant argued that there was no evidence of tax evasion as the non-distribution of the Company’s profits for the year under review was not to reduce the aggregate tax chargeable in Nigeria. The Appellant further submitted that section 21 could only apply where tax evasion was identified as the underlying consideration for non-distribution of profits. In a situation where the non-distribution of profits was informed by legitimate considerations and not intent to avoid or evade tax, as was the case of the Company, section 21 should not apply. The Appellant argued that it was imperative to prove the existence of intent to evade or avoid taxes as the purpose of non-distribution of profits for proper judgment to take place.

The Appellant went on further to explain the reasons for the non-distribution of profits, such as the absence of a recommendation by the directors without which a company cannot declare dividends in a general meeting. The Appellant stated that the Board of Directors did not stand to derive any benefits by enabling the shareholders to evade or avoid taxes on the income. The Appellant further explained that the implementation of Basel II Regulations by the CBN was an obvious and legitimate commercial reason to retain and plough back its 2017 profits into its business for long-term sustainability and increased profitability. As such, the decision was not aimed at tax avoidance or evasion and failure to prove otherwise meant the non-applicability of section 21.

The Appellant submitted that the second condition was secondary to the first condition and would only apply where the purpose of the non-distribution was found to be aimed at tax evasion. The Appellant went on to submit that the phrase “without detriment to the company’s business” in section 21 of CITA was not defined anywhere in the CITA and therefore would require a flexible interpretation to accommodate the peculiarities of each company. The Appellant argued that the profit/loss ratio should not be an appropriate parameter to determine detrimental effects as the distribution of

the 2017 profits would have been detrimental to the Company's business, especially in the face of the losses it had suffered in the previous year just after the injection of an additional **₦3 billion** by the majority shareholder. Relying on *Sanusi v Ayoola & Ors*, the Appellant further argued that the Respondent's demand was still bound to fail even if section 21 of the CITA applied to the case as the direction of the Respondent did not comply with the procedural requirements of the said section of the CITA. The Appellant asserted that the use of "shall" in section 21 (3) and (5) placed an obligation on the Respondent to issue the necessary direction within two years of the receipt of the Appellant's audited accounts. The Company had filed its 2017 audited accounts in 2018 and the Respondent sent its assessment letter in 2021, more than two years after the receipt of the audited accounts. Further, the Respondent's assessment notice to the Appellant did not specify the information prescribed by section 21(3) as mandatory for any direction issued by the Respondent in the exercise of its powers. Such details include the date to be taken for purposes of section 21(2), the net amount of the profits to be deemed distributed, the rate of tax deemed to be deducted, the gross amount which, after deduction of tax at the said rate, left such net amount of those profits, and the net Nigerian rate of tax applicable to those profits.

On the second issue for determination, the Appellant argued that taxes should not apply to non-existent dividends and therefore, penalties and interest should not apply. Relying on *Aerobell (Nig) Ltd & Ors v Fidelity Bank*, the Appellant contended that a company had the exclusive right to declare dividend, and neither section 80 nor any provision of CITA mandated the payment of dividend, hence no imposition of penalties and interest should occur for non-payment of dividend. Relying on Paragraph 13(3) to the Fifth Schedule to the FIRS (Establishment) Act, 2007 (FIRS Act), section 76 of CITA and the decisions in *Ahmadu & Anor v The Governor of Kogi State & Ors, Federal Board of Inland Revenue v Integrated Data Services Limited, Weatherford Services S.D.E.R.L V FIRS*, and *Tetrapak West Africa Ltd v FIRS*, the Appellant further submitted that penalty and interest should not apply because the Appellant promptly objected to the Respondent's additional WHT assessment.

FIRS' Argument

The Respondent formulated three issues for determination. Firstly, it submitted that the WHT on the Appellant's 2017 profit became due the moment the Appellant remitted its 2017 CIT liability. However, since the Appellant failed to adequately fulfill its tax obligation, the FIRS had to apply the provisions of section 21 of CITA. Relying on *Tetrapak West Africa Limited v FIRS, the Respondent* stated that its obligation, according to sections 21 and 66 of CITA, was not to establish tax evasion or avoidance as the ultimate purpose for non-distribution of profits but rather to checkmate companies controlled by less than 5 persons from making decisions that would aid tax evasion or avoidance.

The Respondent argued that the onus rested on the

Appellant to provide compelling proof that the distribution of its 2017 profits would have been detrimental to its business as he who asserts a fact must prove the existence of that fact. They cited legal precedents in the case of *FIRS v New Cross Petroleum Limited, Ahmed Debs & Ors v Cernico Nigeria Ltd and Anionwu & Ors v Anionwu & Anor* to support their argument that the Appellant had not proved that the distribution of profits would be detrimental to its long-term sustainability.

Additionally, the Respondent asserted its responsibility, bestowed by law, to administer all enactments and laws on taxation listed under section 25 of the FIRS Act. They relied on *CMA CGM Delmas SA v FIRS* to maintain that failure of the Appellant to remit tax within the prescribed period, rendered it liable to remit the tax due with penalty for default under section 55 of CITA. The Respondent emphasized that actions or inactions had consequences, citing *Shell Petroleum Dev. Coy. of Nigeria v Abia State Board of Internal Revenue and Sahara Energy Exploration and Production Limited v FIRS*, as well as section 32 of the FIRS Act and sections 55 and 76 of CITA to argue that penalties and interest were the consequences of breaching payment timelines, and any established liability must take effect from the day the duty to pay or remit the tax arose.

Issues for Determination

Based on the prayers and arguments submitted by the parties, the TAT adopted the Appellant's two issues for determination as follows:

- I. *Whether, in light of the provisions of section 21 of the Companies Income Tax Act and the facts and circumstances of this Appeal, the Respondent's assessment of the Appellant to additional WHT on the Appellant's 2017 profits was not wrongful (sic); and*
- II. *Whether the Appellant is liable to pay penalty and interest for not distributing dividends on the Appellant's 2017 profits to its shareholders.*

TAT's Decision

After considering the arguments of both parties, the TAT delivered its ruling.

- I. With respect to the invocation of section 21 of CITA, the Tribunal states the factors on which the appeal is premised as well as the questions that must be answered for proper resolution. Of the five questions, two were considered in depth due to the complexity of answering them. The first is whether the profit could have been distributed without detriment to the Company's business as it existed at the end of that period. The Tribunal rules that the discretion to allow or disregard non-distribution of dividends lies with the Respondent as is reinforced by the term **"where it appears to the Service"**. The Tribunal also relied on *Bertola Machine Tools Limited v Lagos State Board of Internal Revenue* to rule that the Respondent had no obligation to

establish intent to evade or avoid tax because the onus ought to lie on the Appellant as prescribed by paragraph 15(6) of the Fifth Schedule. The Appellant did not provide any evidence such as minutes of board meetings and so the Tribunal naturally agreed with the Respondent that the Company could have distributed profit without detriment to the business operations.

The second and perhaps most controversial question is whether the Respondent acted in line with the direction of section 21(3) in serving the assessment not later than two years after the receipt of the Company's duly audited accounts. The TAT held that since the CITA does not prescribe the form of direction other than it must be in writing and its contents, the form of direction is left to the discretion of the Respondent. The evidence provided revealed that the Respondent informed the Appellant of the WHT assessment 17 months after the receipt of the audited accounts. The Tribunal therefore rules that the Respondent acted in line with the provisions of the relevant section. This issue is resolved against the Appellant.

- II. In deciding the applicability of interest and penalties, the TAT ruled section 76 of CITA and paragraph 13(3) of the Fifth Schedule as inapplicable to the case on the basis that those provisions deal with instances where assessments have become final and conclusive and recovery actions are filed at the Tribunal. Relying on **CMA CGM Delmas v FIRS and MTN Nigeria Communications Plc v FIRS**, the Tribunal ruled that penalties and interest on an assessment are applicable when the tax obligations become due and not when the assessment becomes final and conclusive as was previously ruled in **Weatherford Services S.D.E.R.L V FIRS and Tetrapak West Africa Limited V Federal Inland Revenue**. The Tribunal stated that the case of Shell Petroleum Developing Company of Nigeria v Lagos Board of Internal Revenue served as a self-reversal of that decision and that the right to appeal under paragraph 13(1) of the Fifth Schedule is merely to secure a taxpayer's right to fair hearing. This issue is also resolved against the Appellant.

Ultimately, the matter was resolved in the Respondent's favor and the Appellant was ordered to pay the additional WHT liabilities and the applicable penalties and interest. The Appellant's appeal was therefore dismissed.

Commentaries

The TAT's ruling, to the effect that the discretionary powers bestowed on government agencies and tax authorities cannot be challenged, does not appear consistent with one of the leading ¹cases on this matter. In this case, the court ruled that the exercise of such powers must be reasonable, rational, and done in a lawful manner. In other words, there are limits to the exercise of such powers. It would, therefore, be interesting to see how a higher or superior court would rule on whether government agencies have absolute rights with respect to the exercise of such discretionary powers.

The case also stresses the importance of taxpayers providing compelling and sufficient evidence to support claims related to tax obligations. It highlights the legal principle that the burden of proof lies with the party making a claim, emphasizing the need for thorough documentation and compliance with procedural requirements. However, given the TAT's ruling on the absolute powers of the FIRS in exercising its discretionary powers, the question is whether the provision of compelling evidence would have made any difference?

Notwithstanding the above, the case highlights the need for minutes of board meetings on dividend declaration to contain the basis for the decision to declare or not to declare dividends. It also supports the need for every company to have a properly documented dividend policy that can be provided as evidence in the event of any dispute arising in future. Certainly, the provision of such documents would strengthen the merits of the case if similar issue as in this instant case occurs.

The Tribunal's decision on interest and penalties reflects its adoption of the court's ruling in **CMA CGM Delmas v. FIRS**, marking a departure from its previous stance in the **Weatherford Services S.D.E.R.L V FIRS, Tetrapak West Africa Ltd v FIRS and MTN v. FIRS** ² wherein the TAT ruled that an assessment that has not become final and conclusive should not be liable to interest and penalty. In fact, it stated that the decisions in those cases were made without the consideration of relevant law. In other words, those decisions signify a mistake or oversight by those TAT panels in their decision-making process.

¹ Please see the case of Musical Copyright Society Nigeria (Ltd/Gte) v. Copyright Society of Nigeria (Ltd/Gte) & 2 Ors Suit No.: FHC/L/CS/274/2010

² Please see our Newsletter titled: TAT rules on the interpretation of final and conclusive assessment and other Matters | Issue No. 11.2 | November 2023.

For further enquiries, please contact:

Adewale Ajayi

NG-FMTAXEnquiries@ng.kpmg.com

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Ajibola Olomola: Ajibola.Olomola@ng.kpmg.com

Ijeoma Uche: Ijeoma.Uche@ng.kpmg.com

Olatoye Akinboro: Olatoye.Akinboro@ng.kpmg.com



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