

FHC rules that FIRS is not required to give reasons for adopting a particular percentage of turnover as the basis for the taxation of foreign companies

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The Federal High Court (FHC or “the Court”) Lagos Judicial Division has ruled, in the case between, *BJ Pumping Services SA Panama (BJ Pumping or “the Company” or “the Appellant”)* and the Federal Inland Revenue Service (FIRS or “the Respondent”), that the tax laws do not require the Federal Inland Revenue Service (FIRS) to justify the imposition of any particular percentage of turnover in taxing foreign companies

Facts of the Case

BJ Pumping Services SA Panama, a foreign company with operations in Nigeria, filed its Company’s tax returns for the 2015 to 2017 years of assessment based on its actual profits. The FIRS refused the returns and relied on Section 30(1)(b) of the Companies Income Tax Act (CITA) to impose 6%¹ tax on the turnover of the Company.

BJ Pumping appealed the case before the Tax Appeal Tribunal (TAT or “the Tribunal”). The TAT upheld the FIRS’s position in its judgment by relying on issues raised from further investigation of the Company’s financial records. The Tribunal also failed to address the appropriateness of FIRS’s exercise of discretion based on the evidence presented. BJ Pumping was dissatisfied with the TAT’s ruling as it submitted that the Respondent did not raise the reasons that formed the basis of the Tribunal’s judgment. The Tribunal had made a case which the Respondent did not make. The Company appealed to the Federal High Court, urging the Court to set aside the judgment of the Tribunal.

The Company’s Argument

BJ Pumping argued that the TAT had acted erroneously and exceeded its jurisdiction by basing its judgment on reasons not advanced by the Respondent. The Company contended that issues such as restatement of bad debts, reduction of sales revenue and increased related cost, sketchy details of the components of the inventory and asset impairment figure, existence of some big tickets related party transactions and Appellant’s failure to file transfer pricing returns were all raised by the Tribunal suo motu, without giving the Appellant an opportunity to address those issues. BJ Pumping argued that the Tribunal descended into the arena of conflict by making cases for the Respondent that were hitherto not made. The Company, in support of its argument, cited cases such as *Leaders & Co Ltd vs. Bamaiye (2010)*; *Victio Fixed Odds LTD vs. Ojo & Ors (2010)*; *Ikpeazu vs. Otti & Ors (2016)*; *MTN Nig. Comm. Ltd vs. Sadiku (2013)* to submit that the Tribunal breached its right to fair hearing and as such, the Court should declare the proceedings from the case null and void.

1. When assessing Non-Resident companies for taxation, the FIRS uses this provision to establish a profit ratio of 20% of turnover generated in Nigeria (which implies a cost ratio of 80%). This profit is then taxed at the corporate tax rate of 30%, leading to an effective tax rate of 6% on turnover.

With respect to the issue on the discretionary power of the FIRS, the Company cited cases such as **Fode Drilling (Nig) Ltd vs. Fabby & ORS (2017); Katto vs. CBN (1991); Magna Maritime Services Ltd & Anor vs. Oteju & Anor (2005); Mokeme vs. Okonkwo (2012)**, to argue that the Tribunal erred by failing to rule on whether 20% of the Appellant's turnover during the 2014–2016 financial years constituted a fair and reasonable profit to be taxed, as required by Section 30 of the CITA. The Company contended that the Tribunal, as an intermediate court, has a duty to carefully address all issues raised before it, and its failure to do so infringed upon the Appellant's right to fair hearing, thereby resulting in a miscarriage of justice. The Appellant also presented this as another reason for the Court to declare the TAT's proceedings null and void.

FIRS' Argument

The FIRS contended that a court cannot be accused of raising an issue suo motu if the matter in question is already part of the litigation. To support this argument, the Respondent asserted that a judge is permitted to draw inferences from the facts of a case and to make conclusions based on those inferences. Citing the cases of **Afemikhe & Ors v. Stanbic IBTC Bank (2020) and Ikenta Best (Nig) Ltd v. A.G Rivers State**, the FIRS argued that a court, in delivering its judgment, has the authority to expand the argument on relevant issues and consult external cases and statutes that provide additional guidance on the matters at hand.

With respect to the second issue, the Respondent argued that the Court ought to first decide whether the Tribunal remotely dealt with the issue of the 20% tax deduction before addressing the fairness and reasonability of the same. The Respondent concluded that the Tribunal had correctly based its decision on Section 30 of the CITA.

Issues for Determination

Based on the prayers and arguments submitted by the parties, the FHC adopted the following issues for determination:

- i. *Whether the Tribunal was in breach of the Appellant's right to fair hearing and acted in excess of its jurisdiction when it suo motu in its judgment adduced reasons other than those canvassed by the Respondent and relied on those reasons in upholding the Respondent's assessment of the Appellant to tax under Section 30 of the Companies Income Tax Act, as amended, ("CITA").*
- ii. *Whether the Tribunal was right when it failed to pronounce on the contentious issue of whether 20% of the Appellant's turnover in the years 2014 – 2016 was a fair and reasonable profit to be subjected to tax under Section 30 of CITA, which was raised by both parties before it.*

FHC's Decision

Following a thorough evaluation of both parties' arguments, the FHC reached its verdict by individually addressing both issues as follows:

- i. On the first issue, the Court held that the primary consideration for appointment into the TAT is knowledge of the laws and practice of taxation as determined by paragraph 3 of the fifth schedule to the FIRS (Establishment) Act 2007. Therefore, the TAT studied the primary facts provided by the Appellant and made its inferences. The Court relied on the precedent set by **Ikenta Best (Nig) Ltd vs. A.G Rivers State (2008)** to hold that it is wrong to say that inferences legitimately drawn by a judge from stated facts are introduced suo motu. Judges can draw inferences based on the adjudicatory functions and such inferences can be used to arrive at conclusions. The Court, therefore, dismissed the issue as raised by the Appellant.
- ii. On the second issue, the Court reproduced Section 30 of the CITA, which grants the Respondent the discretion to assess a foreign company to tax on a fair and reasonable percentage of their turnover where it appears that such company has no assessable profit, the assessable profits are less than expected or the profits of the companies cannot be ascertained. The Court held that the Respondent must have acted fairly and reasonably when it opted for 20% of the Company's turnover as profit. The Court submitted that the enabling laws do not require the Respondent to give reasons for choosing a particular percentage. The Court also held that the TAT's affirmation of the Respondent's decision must have been done with fairness on the Tribunal's part and as such, the failure of the TAT to specifically pronounce that 20% of the Appellant's turnover is fair and reasonable did not occasion a miscarriage of justice to the Appellant and did not breach the Appellant's right to fair hearing. Thus, issue two framed by the Appellant was also dismissed.

Ultimately, the matter was resolved in the Respondent's favor and BJ Pumping was directed to pay the tax liabilities.

Commentaries

The FHC's decision reaffirms that judges and adjudicatory bodies like the TAT are allowed to draw inferences from the facts presented during litigation. This decision also gives tax tribunals the authority to examine the broader context of a case, even if that involves making interpretations beyond the arguments presented by the tax authorities.

However, this expansive approach may raise concerns about taxpayers' rights. Transparency and justice in tax adjudication depend on giving taxpayers a reasonable chance to refute any conclusions that the courts may draw from the facts as stated. This decision inadvertently preaches the need for companies to be prepared to address a broad range of issues during appeals. Whilst this keeps taxpayers on their toes, it also provides a loophole that could allow the FIRS to win cases that the Tribunal argues for them. Allowing the Tribunal to act independently without providing the Appellant a chance to respond could be perceived as undermining fair legal processes.

The FHC judgment also holds substantial relevance for foreign companies whose assessable profits would have to be determined by the FIRS under Section 30 of the CITA. Although the law allows the FIRS to choose a percentage of turnover for taxation once the conditions under Section 30 are met, the FIRS should still provide taxpayers with some assurance by explaining how it arrives at a "fair and reasonable" percentage of turnover as profit. This would promote transparency and fairness in tax compliance procedures. To be considered fair and reasonable, the percentage applied to turnover must reflect factors such as the current economic conditions and industry events.

There have been several cases where the courts have held that any discretion exercised by a taxing or regulatory authority must be reasonable, and not arbitrary. Otherwise, this may lead to arbitrariness and bias and may ultimately hinder good governance, justice, and public interest. Given the ruling in this case, what will stop a revenue official from imposing a higher percentage on taxpayers just because he feels like doing this? It is, therefore, important that the issue of discretionary power be revisited to ensure reasonable and informed decision. Interestingly, the TAT also ruled in the case between **Rand Merchant Bank Nigeria Limited and Federal Inland Revenue Service**² that taxpayers could not challenge the discretionary powers of the FIRS.

While the Court did not require the FIRS to justify its choice of 20% as a fair percentage, it is important for taxpayers to demand greater clarity on how such figures are determined. Without statutory guidelines, arbitrary assessments could erode taxpayers' confidence and lead to accusations of administrative overreach.



² Please see our Newsletter titled: TAT rules that the discretionary powers of the FIRS on declaration of deemed profit cannot be challenged | Issue 5.4 | May 2024.

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