FHC rules that ancillary income earned by international shipping companies does not constitute inbound freight income.

Issue No. 10.5 | October 2023

The Federal High Court (FHC or “the Court”) Lagos Judicial Division has ruled in the case between, *CMA CGM Delmas SA (CMA or “the Company” or “the Appellant”)* and *Federal Inland Revenue Service (FIRS or “the Respondent”),* that income from ancillary activities such as cleaning fees, container demurrage etc. does not constitute inbound freight income and, as such, liable to tax in Nigeria.

Facts of the Case

CMA is a French shipping company that is engaged in the transportation of goods from foreign sellers to recipients in Nigeria and from Nigerian sellers to buyers in other countries. The FIRS conducted an audit on the Company's tax returns for 2014 – 2015 Years of Assessments (YOAs) and determined that the Company was liable to additional taxes on income earned in Nigeria. CMA disagreed with these assessments and argued that the additional tax obligations were not applicable in Nigeria, citing relevant provisions from the Companies Income Tax Act (CITA) and the Nigeria-France Double Taxation Agreement (DTA).

Despite CMA's objections, the FIRS issued a Notice of Refusal to Amend (NORA), prompting CMA to appeal the case before the Tax Appeal Tribunal (TAT). The TAT upheld the FIRS's position in a judgment on December 3, 2020. Dissatisfied with the TAT's ruling, CMA referred the case to the Federal High Court.

CMA’s Argument

CMA argued that the TAT should have based its interpretation of Article 8 of the Nigeria-France DTA on the commentary to Article 8 of the OECD Model Tax Treaty. The Company cited precedents like *Ansuldo (Nig) Ltd vs. NPFMB (1991)* and *Daniel vs. Fadugba (1995)* and maintained that prior decisions in similar cases established that *"the same phrase dealing with financial provisions in other statutes should not have different interpretations so as to avoid inconsistency".* Thus, both Paragraph 1 of the DTA and the OECD Model, which are identical, should be construed in a consistent manner. CMA further added that the above commentary holds significance in the interpretation process, citing the Vienna Convention on the Law of Treaties, 1969, which Nigeria has ratified. The company noted that Nigerian courts use this convention to address treaty-related disputes.

Regarding the substance of the matter, the Company acknowledged that it derives income from various sources, including container demurrage, shipping line agency charges, bounded terminal commission, cleaning fee, sale of containers and damage recovery cost as well as NIMASA Environmental Levy. However, CMA argued that its primary source of income comes from the carriage of goods and not the ancillary activities that it inevitably engages in during the carriage of goods into Nigeria. To support this argument, CMA referred to paragraphs 274 of the Bill of Lading and *G & C Lines vs. Hangrace Nig. Ltd (2001).*

© 2023 KPMG Professional Services, a partnership registered in Nigeria and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

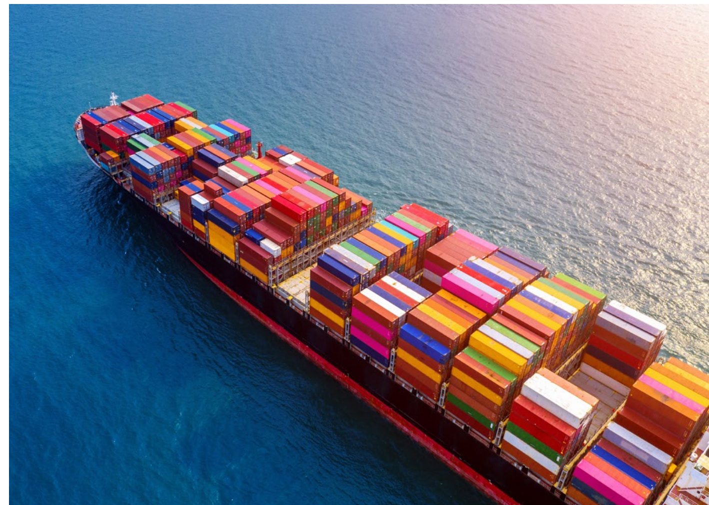
Concerning the issue of penalties and interest, CMA referred to several provisions of CITA, specifically, sections 76, 77, and 85, to assert that they should not be applicable. The Appellant's argument was founded on the assertion that it had timely objected to the FIRS' assessment, and when these objections were denied, it had promptly appealed, which, according to CMA, should have suspended the requirement to make payments until the appeal's determination.

FIRS' Argument

The FIRS argued that the commentaries on the OECD are not International Treaties or National Statutes, but rather personal interpretation of the statutes. These commentaries have never received widespread acceptance, even among various members of the OECD or the United Nations. Therefore, the FIRS contended that the commentaries should be applied as a supplementary means of interpretation. The FIRS further referenced Paragraph 25 of the article, which connotes that the commentaries, although useful in certain circumstances, are not meant to be binding as an international instrument. The FIRS recalled that the TAT had indicated one of such circumstances to be where the provisions of a particular DTA ***are "In principle based on the OECD Model and a certain provision follows the wordings of the OECD Model, it is then reasonable to assume that the contracting states intended such a provision to have the meaning it has in the OECD Model, as outlined in the OECD commentaries".*** The FIRS argued that the Nigeria-France DTA is not worded similarly to the OECD Model and should not rely on the commentaries.

Regarding the income from ancillary activities in which CMA engaged in, the Respondent argued with reference to Section 14 of CITA and Articles 3, 4 and 8 of the Nigeria-France DTA, that the streams of income in question do not qualify as earnings from international traffic and they should not be exempt from taxation under it. According to the FIRS, such income should be considered as domestic traffic earnings and should be taxable under Nigeria's relevant domestic laws. In response to CMA's reference to the case of *G & Clines vs. Hengrace (Nig) Ltd,* the FIRS clarified that the case addressed jurisdictional matters, not tax-related issues.

The FIRS referred to section 32 of the FIRS (Establishment) Act and section 55 of CITA to argue that there was no error in imposing penalties and interest on the assessment since these are statutory levies for failure to pay tax. The FIRS argued that the imposition of penalty and interest is a necessary consequence of the failure of the Appellant to declare its taxable profits as and when due and that the Appellant's argument was out of place. The FIRS pointed to the case of Phoenix Motors Ltd vs. National Provident Fund Management Board (1993) to support its position, stating that lawmakers did not intend for an objection or appeal to absolve the taxpayer from the obligation to pay penalties and interest.



Issues for Determination

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

i. *Whether the income received by the Appellant from container demurrage, container cleaning fees, shipping lie agency commission; unreturned or damaged containers, NIMASA Environmental Levy and bounded terminal commission are taxable under the CITA by virtue of Article 8 of the France-Nigeria DTA;*

ii. *Whether the Tribunal erred in law when it held that penalty and interest in respect of an assessment start to run from the day a taxpayer was required to pay self-assessed tax and not the day that the assessment becomes final and conclusive.*

© 2023 KPMG Professional Services, a partnership registered in Nigeria and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

TAT's Decision

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

i. **Container Demurrage:** This represents the payment made to the Appellant for the late return of containers. The FHC determined that this constitutes additional income for the Appellant and should not be considered as income derived from inbound freight. Consequently, this category of income should be subject to taxation.

ii. **Container Cleaning Fee:** When consignees receive goods and fail to return the container in a clean state, they are charged a cleaning fee. The FHC concluded that this fee is separate from the freight charges already paid under the contract and therefore qualifies as independent income subject to taxation.

iii. **Container Sales/Damage Cost**: This involves payments for unreturned or severely damaged containers. The FHC established that these costs are not part of the originally agreed and paid freight but should be treated as distinct income liable to taxation.

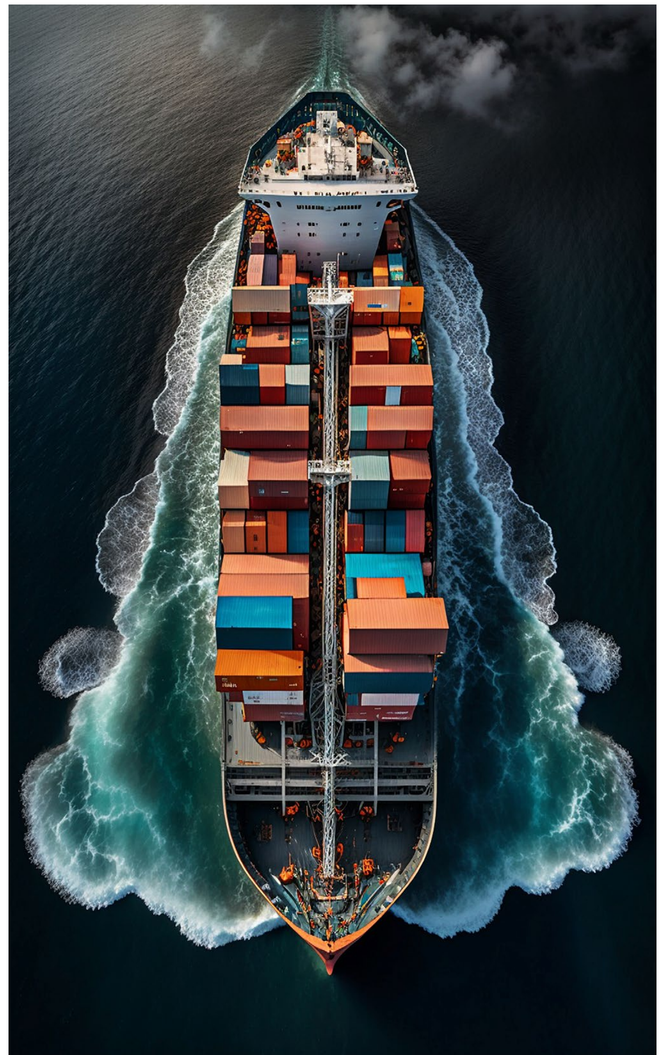
iv. **NIMASA Environmental Levy:** This is an expenditure item incurred by the consignee, which is later reimbursed to the Appellant if the Appellant makes the payment on behalf of the consignee. While this might typically be classified as a reimbursable expense and not liable to taxation, the Appellant admitted that it should be categorized as income. Consequently, the FHC ruled that this income should be subject to taxation.

v. **Shipping Line Agency Charge (SLAC) and Bonded Terminal Commission:** These payments are made by the consignee for services provided by the Appellant. The FHC regarded them as additional income for extra services rendered.

The FHC regarded the different income heads as separate income derived from services provided in Nigeria and agreed with the Tribunal that the various streams of income are not part of the inbound freight which is tax exempt under the combined provisions of section 14 of CITA and Article 8 of the DTA.

From the decision of the Tribunal on the first issue, it is very clear that the Appellant will be liable to any penalty and interest. The issue however is not whether penalty and interest are chargeable but when they accrue. The FHC ruled that the issue of penalty and interest should not have arisen at all as it was not disputed. The matter was thereby resolved in favor of the Respondent.

Ultimately, the matter was resolved in the Respondent's favor and CMA was directed to pay the tax liabilities. The FHC also awarded a cost of **₦200,000** (Two Hundred Thousand Naira) against CMA in favour of the FIRS.



© 2023 KPMG Professional Services, a partnership registered in Nigeria and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Commentaries

This judgment holds substantial relevance for companies operating within the shipping industry. It highlights the importance of recognizing that international tax norms, such as the OECD Model, are not equivalent to Nigerian tax laws. Companies in the shipping sector must prioritize compliance with local statutes and regulations to ensure they are not inadvertently exposed to tax liabilities. It is also important to note that the Finance Act 2020 further gives credence to the FHC's position by subjecting non-freight operations to tax under section 9 of the CITA.

Nonetheless, it appears that the FHC is implying that all income should be automatically considered taxable. A more pragmatic approach for tax purposes would involve both recognizing the reimbursements as expenses initially when incurred by the appellant and income subsequently when reimbursed by the consignee. This method would lead to a zero taxable profit for the Company on the transaction. In our opinion, the FHC's decision to dismiss the Company's claims based solely on the classification of reimbursements as income is not justified.

In addition, the FHC's stance on the imposition of penalties and interest on tax liabilities echoes the position taken in previous judgments on the issue. It underscores the fact that objecting to a tax assessment does not absolve a taxpayer of the obligation to pay interest and penalties for late payment. These financial consequences are not eliminated by the objection; instead, they are a result of the taxpayer's failure to remit taxes in a timely manner. This serves as a reminder to taxpayers to fulfil their tax obligations promptly to avoid incurring additional financial burdens in the form of interest and penalties.

© 2023 KPMG Professional Services, a partnership registered in Nigeria and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

For further enquiries, please contact:

Wale Ajayi
NG-FMTAXEnquiries@ng.kpmg.com

KPMG Nigeria – Tax Dispute Resolution Services

KPMG's Tax Dispute Resolution Services (TDRS) team protects our clients against risks arising from uncertainties in the tax dispute resolution landscape in Nigeria.

Our approach is designed to help you address all your tax disputes through effective strategies that ensure proper mitigation, management and prompt resolution.

How we can support you

In today's interconnected business environment, tax disputes with the revenue authorities are not merely legal controversies: they have commercial considerations which require representation and support by business savvy advisors. By leveraging KPMG's global network of professionals, outstanding relationships with tax authorities and the KPMG network's collective knowledge, our team works to help you achieve the best possible outcomes in technical discourse with the revenue authorities, inclusive of support during prosecution of appeals at the Tax Appeal Tribunal.

Our TDRS team comprises experienced and duly certified practitioners from various professions, including law, accounting, finance and economics. Embedded with subject matter experts on tax compliance and advisory services, KPMG's TDRS team adopts an integrated approach to helping our clients resolve their tax disputes in a cost-effective manner.
Our services include pre-trial advisory services, representation at the Tax Appeal Tribunal, tax litigation support and general tax dispute management.

Connect with us today to understand how our TDRS team can support your business:

Ajibola Olomola: *Ajibola.Olomola@ng.kpmg.com*
Ijeoma Uche: *Ijeoma.Uche@ng.kpmg.com*
Olatoye Akinboro: *Olatoye.Akinboro@ng.kpmg.com*

home.kpmg/ng
Home.kpmg/socialmedia

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2023 KPMG Professional Services, a partnership registered in Nigeria and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.