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TAT rules on non-applicability of VAT on rental income derived from real properties

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The Tax Appeal Tribunal (TAT or "the Tribunal") Lagos Zone has ruled, *in NGX Real Estate Limited (NGX or "the Company" or "the Appellant")* and *Federal Inland Revenue Service (FIRS or "the Respondent")*, that rental income derived from real properties are not subject to Value Added Tax (VAT). The decision brings clarity to the interpretation of the term "interest in land". The thrust of this case was whether the interpretation of "interest in land" should extend to building as the Finance Act (FA) 2019 did not define the phrase; though FA 2020 subsequently modified the exemption to goods and services to include land and building.

Background of the Case

NGX is a company engaged in the acquisition, leasing, hiring, and part-exchanging of real property. NGX had classified its rental income as exempt from VAT. On February 18, 2022, the FIRS issued a letter to NGX, alleging that the company had not fulfilled its VAT obligations for the 2020 fiscal year. The FIRS also provided a seven-day ultimatum for NGX to remit the outstanding tax liabilities.

Dissatisfied with the FIRS's stance and the failure to resolve the matter, NGX filed an appeal with the Tax Appeal Tribunal, seeking to set aside the assessed tax liabilities.

NGX's Argument

NGX contended that the FIRS had misconstrued the key provisions of the VAT Act, as amended by the FA 2019, and had erred in imposing VAT obligations on rental incomes derived from real properties. The Appellant, relying on the definition of goods as provided by Section 46 of the Value Added Tax Act (VATA), stated that goods include tangible products which are movable at the point of supply and intangible products, assets, or property which the ownership or rights can be transferred from one person to another but excludes money, securities and interest in land. NGX further relied on the definition of taxable supplies as provided by Section 2(1) of the VATA (as amended by Section 33 of the FA 2019). According to these statutory provisions, NGX submitted that taxable supplies refer to transactions involving the sale of goods or the performances of a service, for consideration in money or money's worth. The Appellant maintained that taxable supplies regarding goods envisage a sale of taxable goods. Thus, land, not falling into the category of taxable goods, does not fall under taxable supplies. The Appellant also stated that a transaction must qualify as either supply of goods or services for VAT to be applicable on such transaction. Consequently, lease transactions that involve delivering possessory rights to a tenant should not be regarded as taxable supplies. The Appellant drew support from cases such as *Newcomer vs. Coulson (1877), Fearn vs. Tate Gallery (2023)*, and *Onagoruwa vs. State (1993)* and supplied the definitions of land as stated by the courts in the various cases.

Regarding the second issue, NGX argued that the FIRS erred in law by imposing interests and penalties on the demand and re-assessment notice when the same was not final and conclusive.

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Citing Paragraph 13(2) and (3) of the 5th Schedule to the FIRS Act, NGX maintained that a demand notice or assessment could only become final and conclusive if the objector fails to appeal against such demand notice or assessment. The case of *Worldwide Commercial Ventures Ltd. Vs Anambra State Internal Revenue Service (2022)* was also cited in support of this argument.

FIRS' Argument

The FIRS contended that the FA 2019 was the applicable law for NGX's income in 2020. Citing the amendment to Section 46 of the VATA by the FA 2019, the FIRS argued that while the FA 2019 excluded interest in land from VAT, it did not extend this exclusion to buildings. The FIRS further claimed that buildings should not be included in the definition of land, especially since the FA 2020 explicitly accommodated this distinction. In other words, if it was the intention of the Legislature to include building as part of land, it would have stated this explicitly as it did in the FA 2020.

The Respondent further argued that land and building were not classified as assets of the same class. Therefore, the exclusion of interest in land from VAT was introduced in the FA 2019, while the exclusion was extended to buildings in the FA 2020. Consequently, interest in buildings should be subject to VAT in the 2020 financial year (the commencement year of the passage of the FA 2019) but not in the 2021 financial year (the commencement year of the passage of the FA 2020).

Regarding the second issue, the FIRS argued that there was no error in imposing penalties and interest on the VAT assessment since they were statutory levies for failure to pay tax. The FIRS' argument was based on the relevant sections of the VATA and the Federal Inland Revenue Service (Establishment) Act, 2007. The FIRS also pointed out that NGX had admitted, through a letter dated July 14th, that it did not charge VAT on rental income based on the provisions of the Finance Act of 2019. The FIRS considered this as a clear indication of a violation of tax law, relieving the Respondent of the burden of proving the same, and justifying the application of the maximum penalty.

Issues for Determination

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

i. *Whether the Respondent erred in law when it imposed a VAT liability on the Appellant in the sum of **₦36,185,564.25** (Thirty-Six Million, One Hundred and Eighty-Five Thousand, Five Hundred and Sixty-Four Naira, Twenty-Five Kobo) Only or at all, for the Appellant's 2020 Accounting Year;*

ii. *Whether the Respondent erred in law when it charged interests and penalties on the tax assessment or demand notice when same was neither final nor conclusive.*

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TAT's Decision

After careful consideration of the arguments presented by both parties, the TAT held that:

i. The law applicable at the time a course of action arose should be the governing law in a legal case. In addition to this, the TAT stated that retroactive application of laws is not allowed, unless where specifically allowed by the law itself. This statement was further validated by the cases of *Bello vs. State (2014), Rossek & Ors vs. ACB Ltd & Ors (1993), and Afolabi vs. Governor of Oyo State (1985).* The TAT, therefore, held that the relevant law was the FA 2019 which defines what constitutes goods and services for VAT purposes in its amendment of Section 46 of VATA 2007. The Tribunal stated that while the VATA simply defines taxable goods as those not listed in the first schedule to the VAT, the FA goes a step further by defining what generally constitutes goods and services for VAT purposes, including the definition of what constitutes taxable supplies.

   In deciding whether the exclusion of interest in land from VAT extend to developments on land, especially buildings on land used for lease which forms the Appellant's business, the Tribunal referenced the decision of the Supreme Court on the interpretation of "Land". An example of such is the case of *National Electric Power Authority vs. Mudasiru Amusa & Anor (1976)* where the Supreme Court ruled that ***"It is a general rule of great antiquity that whatever is affixed to the soil becomes, in contemplation of the law, a part of it, and is subjected to the same rights of property as the soil itself…".*** Other cases which reinforced this interpretation include *Eze Jesi vs. Eze Jesi (2008) and Unilif Development Co Ltd vs. Adeshigbin (2001).*

   The Tribunal relied on the interpretation given to land in these cases. Therefore, the exemption granted in the FA 2019 in respect of land, should naturally extend to buildings affixed to the land. The Tribunal, therefore, ruled in favour of the Appellant and ordered the assessment of the Respondent be dismissed.

ii. Based on the decision of the Tribunal regarding the first issue, it is evident that the Appellant cannot be held liable for penalties and interest in the absence of a liability on the main assessment.

Ultimately, the matter is resolved in the Appellant's favour and the Respondent is directed to set aside the tax liabilities in the re-assessment notice, as well as the Notice of Refusal to Amend in accordance with the judgment.

Commentary

The TAT ruling has provided a clear interpretation of what qualifies as land and its implications for VAT exemptions, particularly for 2020 financial year. By referencing pertinent judicial precedents such as the case of ***National Electric Power Authority vs. Mudasiru Amusa & Anor (1976), Eze Jesi vs. Eze Jesi (2008),*** and ***Unilif Development Co Ltd vs. Adeshigbin (2001),*** there is now clarity on what constitutes land. This definition holds significant importance for businesses engaged in land development and building leasing as it offers clarity regarding their VAT obligations. It should be noted that FA 2020 has since included land and building as exempt from VAT.

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Furthermore, the TAT's stance on the retroactive application of tax laws carries substantial implications for both tax authorities and taxpayers. Tax authorities are obligated to recognize the importance of adhering to the legal framework that was in place at the time of a transaction or tax event and not apply retroactive changes as they see fit. For taxpayers, this ruling provides a sense of certainty and protection against sudden and unforeseen alterations to their tax obligations. It reinforces the principle that they should not be held accountable for retroactive tax liabilities that were neither anticipated nor enforceable when they took actions or made financial decisions. The legal clarity resulting from this decision empowers businesses and individuals to plan and conduct their affairs with confidence and transparency.

In conclusion, the TAT's decision to dismiss the VAT assessment by the FIRS on NGX highlights the significance of the FA 2019, which amended Section 46 of the VATA. This ruling underscore the importance of legal clarity in tax matters and eliminates any ambiguity surrounding the correct interpretation of the law concerning land and buildings. However, it is important to emphasize that fixtures and structures that can easily be removed will not qualify as such.

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