Another TAT declares commercial rent liable to VAT

KPMG in Nigeria

October 2020

The Tax Appeal Tribunal (TAT or "the Tribunal") sitting in Benin on 9 September 2020 decided in the case between *Chief J.W. Ellah, Sons & Company Limited (CESCL or "the Appellant")* and *Federal Inland Revenue Service (FIRS or "the Respondent")* that rental income derived from the lease of commercial properties is liable to VAT, to the extent that it is not exempted from the First Schedule to the Value Added Tax (VAT) Act. The judgment directly conflicts with the judgement of the TAT Lagos Zone delivered a day later on 10 September 2020 in *Ess-Ay Holdings Limited and Federal Inland Revenue Service* where the TAT held that rental income derived from lease of real estate properties, whether for residential or commercial purpose, is not subject to VAT.

Facts of *Ellah* case relating to VAT on commercial rent and rationale for the decision

While there are various tax issues involved in this case, we have limited our review of the case to the Tribunal's decision that commercial rent is subject to VAT.

The Appellant is involved in the business of maintaining and leasing of real estate properties to commercial and residential customers. It alleged that the Respondent in its revised assessment of 18th December 2018 unlawfully and erroneously assessed VAT on commercial lettings of its premises, being transfer of choses in action which do not qualify as supply of goods and services and are not VATable under Section 1 of the Value Added Tax Act, 1993 as amended (henceforth referred to as "Section 2 of VAT Act, 2004" as amended).

The TAT in its judgement referenced Section 2 of VAT Act 2004, which provides that VAT *"shall be charged and payable on the supply of all goods and services* (in this Act referred to as "taxable goods and services") *other than those goods and services listed in the First Schedule to this Act"* **(emphasis supplied)**, and ruled that:

a. all goods or services that are not expressly exempted as listed in the first Schedule are VATable.

b. building is (*sic.*) not listed as one of the exemptions in the payment of VAT.

Below is an extract from the judgement showing the reasoning of the Tribunal that commercial rent is subject to VAT:

"For purposes or clarity, the law went further to define the most important operational words of "supply of goods and services" in the definition of VAT as follows:

***"Supplies"** means any transaction, whether it is the sale of goods or the performances of a service for a consideration, that is, for money or money's worth;*

***"Supply of goods"** means any transaction where the whole property in the goods is transferred or where the agreement expressly contemplates that this will happen and in particular includes the sale and delivery of taxable goods or services used outside the business, the letting out of taxable goods on hire or leasing and any disposal of taxable goods;*

***"Supply of services"** means any service provided for a consideration;*

*We view these definitions very apt in resolving the contentious issue raised by parties on whether rent on residential or commercial buildings are subject to VAT. From the above definitions, Supply of goods includes the **letting out** of goods on **hire or leasing.***

*The Longman Dictionary of Contemporary English defines **let out** as "charge someone an amount of money" for the use of a room or building". The same dictionary gave the meaning or **Hire** as "to pay money to borrow something for a short period of time". In this case, it means to pay money for a periodic or temporary use of a building and similarly the Cambridge Dictionary defines Leasing as a financial arrangement in which a person, company, etc. pays to use a land, a vehicle. etc. for a particular period of time.*

From the above, it is obvious that commercial buildings where a charge, fee, rent or any other consideration is payable is subject to VAT whereas domestic or residential buildings, in our opinion are not VATable.....

We are, therefore, strongly convinced that the Respondent is right to demand for VAT on the commercial buildings of the Appellant."

Commentaries:

The TAT has by its judgment in this case effectively equated a *"building"* with a *"good"* just because a building or a part thereof can be let out, just as a good (moveable in this context) can be let on hire or lease. However, this is a flawed premise on which to conclude that rent on properties is VATable.

The fact that both *"buildings"* and *"goods"* can be *"let out"* does not and cannot make a building a good, as the similarity of the nature of a transaction affecting buildings and goods cannot change the intrinsic nature of a building, and thus make it a good.

The TAT was unduly influenced by the part of the charging provision of Section 2 of the VAT Act that imposes VAT on the supply of all goods and services *"other than those goods and services listed in the First Schedule to this Act."* To the Tribunal, any *"good"* that is not exempted in the First Schedule to the Act is VATable. While this is correct in principle, the Tribunal skipped the foundational step of defining a *"good"* first as the basis for determining whether a building can be so categorized. If the Tribunal had done this and properly directed itself, it would have concluded that a building is not a good and, therefore, not subject to VAT as the TAT Lagos Zone did in *Ess-Ay Holdings case*. And if a building is not a good, it means it is not VATable. Hence, the non-inclusion of rent on buildings in the list of exempted items in the First Schedule to the Act as the basis of making it VATable would be a moot point.

Furthermore, since the Tribunal concluded that a "building" is a VATable good (because it is not exempted from VAT in the First Schedule to the Act), then it had no legal basis for distinguishing a commercial lease rental from a residential lease rental, and exempting the latter from VAT in the absence of an express provision in the VAT Act to that effect.

The Appellant's counsel in his submission curiously cited paragraph L(C)(6) of the FIRS' Information Circular No. 9701 of 1st January 1997 (hereafter referred to as "the Circular"), which exempts rental income from residential leases from VAT. While the Tribunal rightly acknowledged that "the FIRS circulars and guidelines cannot take the place of the law", however, it concluded that the Circular validated its position that rental income from commercial leases is not exempted from VAT. To further support its position, the Tribunal cited the decision of the defunct VAT Tribunal in *Federal Board of inland Revenue Vs Ibile Holdings* (2006 All NTC Vol. 6 page 1), where it was wrongly held that building, selling and renting properties, which constitute commercial rents collected from commercial properties, are subject to VAT.

It is indisputable that any instrument, such as guidelines or circulars, issued by an administrative agency of government pursuant to a legislation, can only be upheld if its provisions are consistent with the provisions of that law, and cannot be used as a tool to amend, vary or alter it. Hence, since the Tribunal acknowledged that the Circular is an administrative instrument that cannot take the place of the law, its decision should have been hinged on the correct interpretation of the provision of Section 2 of the VAT Act, 2004, where the definition of "goods" cannot be stretched to capture rent from both commercial and residential leases as VATable.

The existence of the two conflicting TAT judgements implies that we can only have clarity on this matter when the Federal High Court has the opportunity of reviewing the judgements on appeal. This would be necessary to resolve legacy disputes on the subject arising under the VAT Act 2004 prior to its amendments by Finance Act, 2019. Until then, it is predictable that both the taxpayers and the FIRS will continue to challenge each other's stance on the subject.

Meanwhile, as we have said elsewhere *(KPMG Tax Alert No. 9.2 of September 2020)*, the reasoning of the TAT in *Ess-Ay Holdings* makes the judgement supportive of the non-VATability of rent under the VAT Act as amended by Finance Act, 2019, even though it was based on VAT Act, 2004, prior to its recent amendment by Finance Act, 2019.

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