

Commentaries on the VAT (Modification) Order, 2021

KPMG in Nigeria
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The Value Added Tax (VAT) (Modification) Order, 2021 ("the Order") was signed on 30 July 2021 by the Honourable Minister of Finance, Budget and National Planning (HMoFBNP), Mrs. Zainab Shamsuna Ahmed, pursuant to her powers under Section 38 of the VAT Act, Cap. V1, Laws of the Federation of Nigeria, 2004 (as amended). The Order was subsequently published by the Federal Government of Nigeria (FGN) in its Official Gazette No. 167, Vol.108 of 21 September 2021.

The Order replaces the VAT (Modification) Order 2020, amends the First Schedule to the VAT Act by defining and expanding the list of goods and services listed in the First Schedule to the VAT Act, and provides clarification on the amendments introduced to the VAT Act by Finance Act, 2020.

This publication analyses the impact of the Order on taxpayers and businesses operating in affected sectors of the Nigerian economy.

1. General Implications of the Order

The Order introduces new definitions, and revised definitions, for some of the terms in the First Schedule to aid taxpayers' interpretation and treatment of goods and services for VAT purposes. The Schedule to the Order also expanded the list of exempt goods and services with their relevant Common External Tariff (CET) code to provide additional relief to qualifying taxpayers.

However, there are some amendments in the Order that may require further revision to ensure consistency with the Principal Act and other fiscal laws and policies in the country. For instance, the *VAT Rate of Tax Chargeable Order, 2007* amended item 6 of Part I and Item 4 of Part II of the First Schedule to the VAT Act by excluding "*non-oil exports which enjoy zero rated status*" from VAT exempt status. Therefore, the deletion of non-oil exports from zero rated goods in the Order, without a concurrent amendment of items 6 and 4 of Parts I and II, respectively, to delete the following words "*excluding non-oil exports which enjoy zero rated status*" could be misinterpreted to mean that non-oil exports are now precluded from VAT exemption. Obviously, this cannot be the intention of the Order as it contradicts the Federal Government's export expansion policies and its intention to drive economic growth through fiscal incentives that encourage increased export capacity.

Further, the transfer of non-oil exports from zero-rated goods to VAT exempt will prevent taxpayers from claiming input VAT as there will be no output VAT charged on the sales (which was zero percent prior to the Order). This will potentially increase the cost of business for companies engaged in non-oil exports as they would have to expense their input VAT rather than recover the amount through the input-output mechanism.

2. Implications of the Order for Financial Services Industry

The Order modifies Paragraph 2 of Part II of the First Schedule by restricting VAT exemption to services rendered by Unit Microfinance Banks (MFBs) and Mortgage Institutions only. Specifically, the Order defines "*Unit Microfinance Banks*" as microfinance banks categorized by the Central Bank of Nigeria (CBN) as Tier 1 or Tier 2 Unit MFBs.

Historically, the VAT Act exempted "*services rendered by Community Banks, People's Bank and Mortgage Institutions*" from VAT. However, in 2007, the CBN revoked the erstwhile Community Banking license and directed community banks to convert to MFBs which are in 3 categories: Unit MFBs (authorized to operate in one location only), State MFBs (authorized to operate in one State or the Federal Capital Territory (FCT), and National MFBs (authorized to operate in more than one State including the FCT). Notably, the conversion of Community Banks to MFBs was not reflected in the VAT Act until Finance Act, 2019 amended the reference to Community Banks to MFBs in Paragraph 2 of Part II of the VAT Act.

The implication of the lacuna prior to 2019 was that the tax authorities strictly interpreted Paragraph 2 of Part II of the VAT Act by subjecting the services of most MFBs to VAT, since such services were not listed as exempt. Hence, the amendment introduced by Finance Act, 2019, resolved the longstanding debate by qualifying them for VAT exemption consistent with the original intent of the provisions of the VAT Act. However, the Order appears to have reset the progress made, thus far, by restricting exempt MFB services to those provided by Unit MFBs only, and thereby subjecting the services of State and National MFBs to VAT.

In the past, tax authorities argued that only Unit MFBs maintained the original elements of the erstwhile Community Banks, therefore, only services rendered

by Unit MFBs should be exempted from VAT. However, there is no legal basis for the argument given that all MFBs maintain similar business activities and target customers. Specifically, Provision 1.2.2 of the CBN's Revised Regulatory and Supervisory Guidelines for MFBs in Nigeria, provides that all MFBs, irrespective of category, are focused on the same target customer base which includes: *"economically active low-income earners, low-income households, the un-banked and under-served people, in particular, vulnerable groups such as women, physically challenged, youths, micro-entrepreneurs, informal sector operators, subsistence farmers in urban and rural areas."*¹

VAT is an indirect tax which is borne by the final consumer. Therefore, the inclusion of VAT on the services rendered by the State and National MFBs basically transfers that burden to the low-income consumers of the affected MFBs. Given that State and National MFBs have a wider geographic coverage than Unit MFBs, it is expected that a significant number of poor and low-income earners will be subjected to the additional VAT cost. This will increase the cost of financial access for the poor and low-income earners, which is counterproductive to the objectives of deepening financial inclusion in Nigeria.

It is, therefore, hoped that this definition will be revised to include the services of all MFBs in the exempt list, in line with the Federal Government's policy on financial inclusion and poverty alleviation.

3. Implications of the Order for Energy Sector

3.1. Modification of the definition of "Petroleum products"

The Order defines "Petroleum products" as "aviation turbine kerosene, premium motor spirit, household kerosene, and locally produced liquefied petroleum gas (LPG) and Crude Petroleum oils" (i.e. Petroleum Oils and Oils obtained from bituminous minerals, Crude). This suggests that Automobile Gas Oil (AGO) (i.e., Diesel), which was hitherto included in the definition of petroleum products, that qualified for VAT exemption in the VAT Act (Schedule Modification) Order, 2018 ("VAT Order, 2018"), may no longer be a VAT exempt petroleum product. While the seeming exclusion of AGO from VAT exemption may reinforce the deregulation of AGO marketing in Nigeria, the key question is what do the phrases: 'crude petroleum oils' and 'petroleum oils' mean? Can these be extended to cover diesel?

Interestingly, there is no specific petroleum product that is referred to as "petroleum oil". Rather, the word is of general application referring to liquid petroleum products. It also appears that there is a careful attempt to distinguish the specific oil covered from other oils with the use of the modifier 'petroleum'. In other words, petroleum oil will not extend to edible oils, such as vegetable oil, palm oil, and other types of oils, not obtained from crude oil or bituminous minerals. Simply put, any oil derived from crude should qualify under the general words 'petroleum oil' based on the *ejusdem generis* principle of statutory interpretation.

It should be noted that the exempt items are being identified by their CET Codes. Thus, as there is no specific CET Code for diesel, this may explain why it is not specifically listed in the Order. The only item that it can fit under is petroleum oils under the general CET code 2709 0000 00. However, it is important that there is clarity on the tax-exempt status of diesel to avoid unnecessary dispute as was provided in the erstwhile VAT Order, 2018. Pending this clarification, it will be interesting to see how the general phrase – "petroleum oils" will be interpreted and applied in practice.

Further, the Order was made available to the public in October 2021 though it was issued on 21 September 2021. The question, therefore, is whether companies in the oil and gas industry will be subjected to back-duty assessments on VAT that should have been charged on the sale of AGO during the lag between the commencement date and date of issuance of the Order? However, as the amended definition of petroleum products in the Order was unavailable to the public during the period, and the term "petroleum oils" can be interpreted to include AGO/ diesel, the affected companies should be able to make a case against back-duty assessment by the FIRS.

Whilst it is unclear whether the continued exemption of the specified petroleum products from VAT is evidence that the Federal Government of Nigeria (FGN) will continue to participate in the downstream sector, it is noteworthy that excluding these items will make the products more affordable for the populace. However, the consensus is that the continued regulation of prices of petroleum products is not sustainable and will not attract the desired investment into the sector.

¹<https://www.cbn.gov.ng/out/2013/ccd/amended%20regulatory%20and%20supervisory%20guidelines%20for%20mfb.pdf>

3.2. Exemption of Gas supplied within the Power Sector

The Order has exempted gas supplied within the Power Sector Value Chain from VAT. This is a welcome development as it would have an impact on the liquidity issue that has plagued the sector over the years. It also demonstrates the commitment of the FGN towards reducing the tax burden of operators in the sector and improving the ease of doing business. The exemption would have a positive impact on electricity tariffs as the VAT incurred on gas supplied within the sector would have been recovered from the end-users.

However, there are questions as to whether the reference to generation companies (GENCOs) relate only to the successor generating companies of the erstwhile Power Holding Company of Nigeria. To the extent that there is no specific definition of GENCOs in the Order, it should be given its plain meaning and interpreted broadly and not narrowly. Therefore, our position is that any gas supplied to electricity generating companies, including Independent Power Plants and the National Independent Power Projects, will qualify for VAT exemption.

It is understandable why the VAT-exempt status is limited to electricity supplied to the National Grid or NBET and electricity transmitted by the Transmission Company of Nigeria (TCN) to Electricity Distribution Companies (DISCOS). Any other supply of electricity will be to the final consumers, such as eligible customers under the Eligible Customers Regulations. Given that the electricity supplied by the DISCOS will remain VATable, it makes sense that the same treatment should apply to electricity supplied to customers under the Eligible Consumers Regulations. However, there are instances where GENCOs supply power directly to eligible customers using the grid facilities and TCN. It is unclear whether these instances would be covered by the exemption.

3.3. Exclusion of previously exempt items – Natural Gas, imported liquefied petroleum gases and other gaseous hydrocarbons

As noted in (3.2) above, only gas supplied to GENCOs is VAT exempt. Consequently, gas supplied to the commercial sector (those that use gas as fuel) and gas-based industries (those that use gas as feedstock, such as petrochemical and fertilizer plants) will remain VATable. There is no plausible explanation for this exclusion as these two sectors, together with power, form part of the priority sectors.

Further, it should be noted that imported LPG will be subject to VAT.

3.4. Exempt Renewable Energy Equipment

Globally, there is a conscious effort to transit from hydrocarbon energy to cleaner sources of energy, as countries and oil producing companies are pledging “*net zero emissions*” targets. At the 2021 United Nations Climate Change Conference under the umbrella of COP26, which was hosted by the United Kingdom (UK), His Excellency, President Muhammadu

Buhari, GCFR, pledged that Nigeria would achieve net zero emissions by 2060.

In line with the intention of the FGN to increase the supply of renewable electricity from 13% of total electricity generation to 23% in 2025 and 36% by 2030, Renewable Energy Equipment (REE), which was introduced as an exempt item in the 2020 Modification Order, remains VAT exempt.

The exemption of REE from VAT demonstrates the FGN’s commitment to attracting investments to the renewable energy sector, which is very capital intensive. This will also go a long way in helping the country meet its Nationally Determined Contribution (NDC) aimed at reducing Green House Gas (GHG) emissions by 20% unconditionally and 45% with international support by 2030.

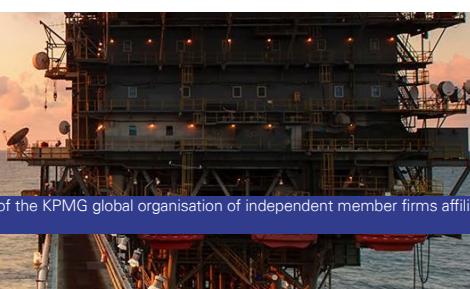
4. Implications of the Order for Consumer & Industrial Markets, Infrastructure and Agriculture Sectors

The most significant amendment introduced by the Order for Consumer & Industrial Markets is the deletion of “non-oil exports” from the list of zero-rated goods and services in Part III of the First Schedule to the VAT Act. Consequently, non-oil exports would now be treated as VAT exempt in line with Paragraph 6 of Part 1 of the First Schedule. Although, as highlighted in 1 above, a concurrent amendment of items 6 and 4 of Part I and Part II, respectively, of First Schedule to the VAT Act is necessary, to delete the following words “*excluding non-oil exports which enjoy zero rated status*” to ensure consistency of the Act with the Order.

The implication of this amendment is that non-oil exporters will no longer be entitled to a refund of input VAT paid on raw materials and other goods used in the production of exported items. Such VAT would have to be treated as qualifying expenses against the revenue of the exporter. While this amendment may positively impact the income tax position of the exporting entity, it may negatively impact the entity’s cash flow position over time. Hence, it is important that exporters re-evaluate their cash management position in view of this amendment.

Further, the Order defines the scope of the exempted items in the First Schedule of the VAT Act, in addition to providing a detailed list of all exempted items and their CET Codes. For example, the scope of qualifying “*basic food items*” and “*commercial aircrafts*” that have given rise to disputes between taxpayers and the FIRS have now been clarified in the Order. Therefore, manufacturers, importers and providers of VAT-exempt goods and services should carefully consider the scope of the exemptions provided in the Order when evaluating the VAT status of their products.

Another noteworthy development for the Infrastructure Sector is the deletion of the term “*lease and rental of residential accommodation by persons other than corporate entities*” which was introduced by the VAT (Modification) Order, 2020 to apply VAT on lease/ rental of a residential apartment if the property was rented by a corporate entity. However, the term has now been deleted



by the Order, to align it with the amendments introduced by Finance Act, 2020 to the VAT Act which exempts lease/rental of a building by either individuals or corporate entities from VAT.

Other relevant sectoral amendments introduced by the Order are:

4.1.Consumer and Industrial Manufacturing Sector

The list of exempted items has been extended to include:

- Raw materials used to produce baby diapers and sanitary towels.
- Raw materials used to produce pharmaceutical products.
- Military hardware, arms, ammunition, and locally manufactured uniforms used by the Armed forces, para-military and other security agencies of governments in Nigeria.

The exemption of the raw materials stated above is a positive development considering that the related final products are also VAT exempt. This exemption should positively impact the market price of the final products and the cash flow of the manufacturers of such products.

4.2.Agriculture Sector

The Order exempts locally produced animal feeds and agricultural seeds and seedlings from VAT. This exemption will significantly benefit agricultural companies incorporated in Nigeria that engage in primary agricultural production by making animal feeds and seedlings readily available to local farmers at a lower cost.

Relatedly, paragraph 5 under Part I of the First Schedule was amended from "*Fertilizer, locally produced agricultural and veterinary medicine, farming machinery and farming transportation equipment*" to "*fertilizers, and locally produced agricultural chemicals, and locally produced veterinary medicine*" thereby excluding "farming machinery and farming transportation equipment" from the list of exempt items. However, this appears to be an

omission error, as the extended list of items with CET codes retains "*tractors, plough and agricultural equipment and implements purchased for agricultural purposes*" as part of VAT exempt items. Therefore, a further amendment of Paragraph 5 of the First Schedule is required to ensure consistency in the list of items in the Schedule to the VAT Act and Order respectively.

4.3.Transportation Sector

Public road transportation services are now exempted from VAT. The Order, however, excludes leased, hired, or rented motor vehicles and ride hailing transport services from enjoying this exemption.

The exemption of public road transportation from VAT is a welcome development and would significantly impact interstate and international travel by road. Hopefully, this exemption would be extended to the transportation of food and other essential commodities by road or air, which should have an indirect impact on the cost of these items.

Notably, the specific exclusion of riding hailing services from the list of exempted services reflects the FGN's fiscal direction on taxation of the digital economy, where ride hailing services operate.

5.Conclusion

We commend the HMofBNP for issuing the Order, as it clarifies a number of issues for businesses. Notably, the Order has a commencement date of 30 July 2021, although it was published on 21 September 2021 and became publicly available in October 2021. Therefore, it is expected that taxpayers would be given sufficient time to update their systems with the modifications introduced by the Order to ensure seamless transition and compliance.

Further, there should be a mechanism for proper communication between the various authorities and agencies responsible for the implementation of the Order especially at the different ports to ensure consistency across the board.

In the meantime, taxpayers are advised to take note of the amended definitions in the Order and ensure compliance accordingly.

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