Detail

WHICH FINANCIAL INSTITUTIONS' TRANSACTIONS ARE LIABLE TO VALUE ADDED TAX IN NIGERIA? THE FIRS PERSPECTIVE AND MATTERS ARISING

Value Added Tax ("VAT") is a consumption tax that is levied at the rate of 7.5% on the supply of all goods and services that are backed by consideration, other than those goods and services that are specifically exempted under the First Schedule to the Value Added Tax Act, Cap. V1, LFN 2004 as amended ("VAT Act"). In this regard, Part II of the First Schedule to the VAT Act (as amended by the Finance Act, 2019) exempts services rendered by microfinance banks, peoples' banks and mortgage institutions from VAT. Therefore, by implication all other financial institutions are required to charge VAT on their services.

In view of the above, the Federal Inland Revenue Service ("FIRS") on 31st March, 2021 issued Information Circular No. 2021/04 and titled "Value Added Tax (VAT) on Services of Financial Institutions" (the "FIRS Circular") which clarifies the position on chargeability of VAT on services rendered by financial institutions.

This article highlights the key provisions of the FIRS Circular and the legal issues arising from the FIRS Circular.

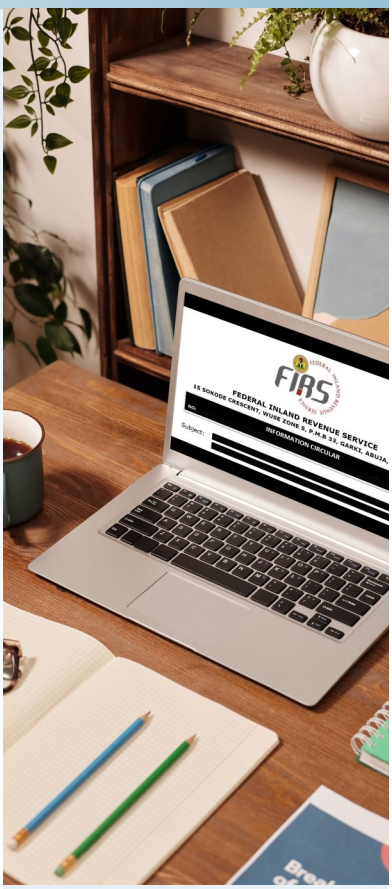
HIGHLIGHTS AND NOTABLE PROVISIONS OF THE FIRS CIRCULAR

1. Definition of Financial Institutions

The FIRS Circular defines financial institutions to mean *"any bank, individual, body, association or group of persons, whether corporate or unincorporated, licensed under Banks and Other Financial Institutions Act and any other related Act which carries on the business of a discount house, finance company, money brokerage and those whose principal objects include factoring, project financing, equipment leasing, debt administration, fund management, private ledger services, investment management, local purchases, order financing, export finance, project consultancy, financial consultancy, pension fund management and such other business as the Central Bank of Nigeria, Nigeria Deposit Insurance Corporation, Pension Commission and other regulatory body may, from time to time, designate."*

2. Services of Financial Institutions Liable to VAT and Incomes not Liable to VAT

In determining what financial services are liable to VAT, a distinction is made between the activities that constitute return



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on investment or consideration for risk, etc. on one hand, and those that constitute supply of services by the financial institutions on the other hand. In the case of the former, the FIRS Circular states that the provision of loans and advances does not constitute a transaction liable to VAT. As such, the interest chargeable on the loans and advances will not be liable to VAT. The table below further highlights a non-exhaustive list of the incomes earned by Financial Institutions that will fall under the former category and, therefore, not liable to VAT:

Nature of Activities of Financial Institutions that are not Liable to VAT	
1. Interest on loans and advances, including overdraft facilities	2. Interest on savings accounts
3. Interest on bank deposits	4. Interest on interbank placements
5. Premium on insurance policies	6. Dividends
7. Profit or gain on disposal of securities	

The FIRS Circular states that all charges, fees and commission arising from the services provided by financial institutions to their customers will attract VAT. These commissions, fees, or other charges include and are not limited to the following:

Nature of Services of Financial Institutions Liable to VAT	
1. Commissions charged on forex trading or remittance	2. Commissions on sale of Bank drafts/certified cheques
3. Account maintenance fees, ledger fees etc.	4. Commission on asset trading
5. Legal and other fees chargeable on lease arrangements	6. Commissions paid to brokers, reinsurers, underwriters and other insurance agents by an insurer
7. Fees earned on fund management	8. Fees chargeable on public/private issues
9. Debt conversion fees	10. Fees on asset trading
11. Fees charged for advisory services e.g. mergers and acquisition, financial strategy counseling etc.	12. Fees earned on letters of credit/documentary collection to finance import/export
13. Fees chargeable on stock-brokerage and trust services	14. Fees charged on electronic banking, POS and ATM charges
15. Fees charged on electronic bill payments	16. Mobile money transactions and other like transactions

3. VAT Registration and Rendition of Returns

Given that financial institutions are taxable persons within the provisions of the VAT Act, and the fact that the services provided by them to their customers are generally liable to VAT (with the exception of the services of microfinance banks, peoples' banks and mortgage institutions), these financial institutions are required by law to register for tax/VAT and obtain a Tax Identification Number. Furthermore, these financial institutions are required to render/file VAT returns to the relevant tax office not later than 21st of every month following the month of their transactions.

4. Charging of Input VAT by Financial Institutions

Input VAT refers to VAT paid on goods that are purchased for resale and goods which form the stock in trade used for the direct production of any new product. Output VAT, on the other hand, is charged when the purchased goods are sold.

Accordingly, the FIRS Circular clarifies that all input VAT payable in respect of assets

purchased for use by the financial institutions (i.e not for resale) should be added to the cost of the assets on which capital allowances may be claimed in line with the provision of section 17 of the VAT Act as amended.

Similarly, all VAT payable in respect of services consumed by financial institutions should be expensed in the Statement of Profit or Loss Account/Statement of Comprehensive Income as normal operational expenses and should not be deducted from output tax collected by the financial institutions. However, where financial institutions suffer input tax on goods supplied to customers, such input tax shall be allowed against the output tax on those goods.

5. Obligation to Account for VAT

The Circular clarifies that the primary obligation to charge and remit VAT on services falls on the person providing the service. However, the instances when this obligation may shift in the financial service sector include the following:

a. In case of agency or broker arrangements where the agent or broker acts as intermediaries between the service providers and the customers, the obligation to charge and remit VAT will lie with the agent or broker;

b. Where the agent or broker cannot charge VAT due to being either individuals (including staff of the financial institution), or being a person below the VAT threshold of N25,000,000, the financial institution will have the obligation to self-account and remit the VAT to the FIRS;

c. Where the agent or broker fails to charge VAT, it shall be the obligation of the financial institution to self-account and remit the VAT to the FIRS; and

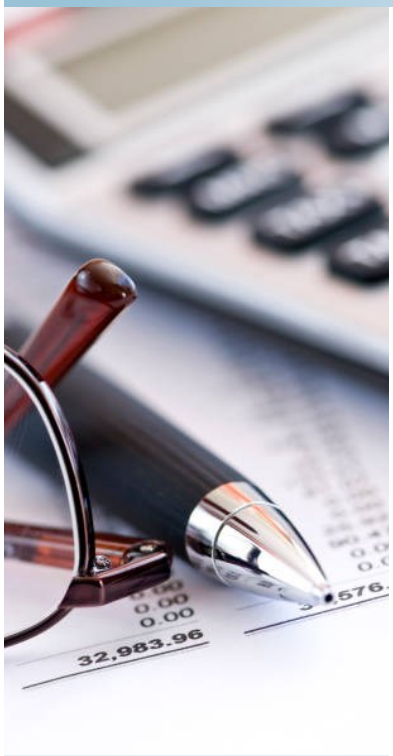
d. Where the broker or agent fails to charge and collect, or charges and collects but fails to remit the tax, the penalties prescribed in the relevant tax laws shall apply.

Matters Arising

- The position of the FIRS in a tripartite transaction involving a financial institution, its broker or agent and the customer
- Obligation on financial institutions to self-account and remit VAT to the FIRS
- Penalties for the broker or agent

Matters Arising

In line with the spirit of its other clarification circulars, the FIRS Circular provides much-needed clarity on the nature of transactions in the financial services sector that are liable to VAT and those that are not liable to VAT. However, there is the



risk that, based on factual scenarios, some positions in the FIRS Circular may not align with the extant provisions of the VAT Act.

Of particular concern are the following:

a. The position of the FIRS is that in a tripartite transaction involving a financial institution, its broker or agent and the customer, the party that has the obligation to charge VAT on such transaction is the broker who acts as an intermediary. Such a conclusive categorisation may not be correct in all instances. It is imperative to note that by the VAT Act, the obligation to charge VAT in transactions is on the service providers, save for transactions in the oil and gas sector where the consumer of the service has the obligation to self-account for VAT on the transaction irrespective of whether VAT was charged on the transaction. Therefore, depending on the factual scenario in consideration, where the financial institution and not the broker is the entity issuing the invoice on the tripartite transaction, the financial institution will have the obligation to charge the resulting VAT. In other words, where the agent/broker strictly acts as an intermediary by bringing the financial institution and the customer together and does not issue an invoice on that transaction or transmits one issued in the name of the financial institution, the financial institution should have the obligation to charge VAT on the transaction. Conversely, where the broker is construed as the service provider in that transaction or issues the invoice for the transaction, the broker will have the responsibility to charge the resulting VAT.

b. Similarly, the FIRS Circular states that a financial institution will have the obligation to self-account and remit VAT to the FIRS where its agent or broker cannot charge VAT for certain reasons. However, based on the provision of section 14(4) of VAT Act, the person that has the obligation to self-account for VAT where VAT is not charged on a transaction is the consumer of the VATable supplies and not the service provider/financial institution in this instance. As such, the FIRS' position that the financial institution will have that obligation does not align with the VAT Act.

c. Finally, the FIRS Circular states that the broker or agent will be penalised in accordance with the law where it fails to charge and collect VAT on its transactions. This position will be limited in its application in view of the provisions of

the VAT Act which exempt the agent/broker from the obligation to charge or collect VAT where its VATable supplies in a calendar year is below the VAT threshold of N25,000,000 or where the agent/broker does not expect to make VATable supplies which are up to N25,000,000 in the calendar year.

Conclusion

One of the widely acknowledged principles of a good tax system is certainty. Certainty should mean that taxpayers are clearly informed about why and how taxes are levied. There is no doubt that the FIRS Circular was issued to provide the much-needed clarity and certainty in relation to the application of VAT in the financial services sector. Accordingly, financial institutions and their agents are advised to note these important clarifications in their dealings with the customers and third parties and ensure that VAT is charged on the qualifying transactions and remitted timeously to avoid sanctions and penalties.

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