VAT Refund System

Abiola Sanni

The Chartered Institute of Taxation of Nigeria
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PREFACE

Since the promulgation of Decree No. 76 of 1992 establishing The Chartered Institute of Taxation of Nigeria, the Associateship (ACTI) or Fellowship (FCITI) qualifications have become the benchmark for tax practice in Nigeria.

The purpose of the Tax Practice Series is to place emphasis on practical application and ensure that CITN members or students build skills that are directly applicable to their daily work or study environment.

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Professor M. T. Abdulrazzaq, FCTI
Registrar/Chief Executive
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1st November, 2001
FOREWORD

It gives me great pleasure to write the foreword to this issue which is the third issue in the Tax Practice Series and to be part of its historic commencement.

The topic contained in this issue deals with VAT Refund System and attempts to explain the law, practice and administration of an issue which is at the core of tax practice.

As there are few materials and written texts on Nigerian taxation a Tax practitioner and student is in an unenviable position. He is likely to be uncertain of the source to consult and even if he finds them he is unlikely to comprehend their full implication.

The intention of the Tax Practice series therefore is to present the subject in a brief but, it is hoped, comprehensive manner at a price that should be within reach of students and most tax practitioners.

I hope therefore that the Tax Practice Series will be found a useful practical aid to students taking the Institute’s examinations as well as to practitioners.

*Bimpe Balogun, FCTI
President,
The Chartered Institute of Taxation of Nigeria
Lagos.

1st November, 2001
VAT REFUND SYSTEM IN NIGERIA – A CRITIQUE

Claims for tax credits are an inherent part of VAT which is a tax on differences. Any attempt to curb input is therefore wrong in principle because it changes the way VAT operates from a tax on value added to a tax on gross sales prices.\textsuperscript{2}

\ldots\ldots in many developing countries, the refund is perceived as the major potential weakness of the VAT and the main avenue of evasion; therefore, the authorities are reluctant to be too prompt on refunds, preferring to have time to inspect, in detail, large refund claims. This is a prudent requirement in any VAT system.\textsuperscript{3}

1. Introduction

Undoubtedly, no provision of the Value Added Tax Decree\textsuperscript{4} in Nigeria has generated as much controversy as the one on refund. The problem mainly centers on how to harmonize two seemingly opposing objectives of protecting the revenue of the government and promptly granting applications for refund.

The aim of this paper is to examine and clarify the refund system in Nigeria. The various circumstances that are likely to lead to claims of refund will be discussed. The scope of the recent amendment, which attempted to expressly define “deductible and non-deductible inputs” will be analysed. It is our view that the provision is inelegantly drafted and

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\textsuperscript{4} Decree No. 102, 1993.
riddled with many ambiguities. The paper is concluded with suggestions on how to achieve a more effective and equitable refund system in the country.

1.2 Credit and refund systems explained

The Value Added Tax operates on the basis of self-assessment. When a taxable person is rendering his periodical return, he is entitled to deduct his input tax from his output tax. In this way, he pays tax to the tax authority only on the value added by him unlike the final consumer who pays tax (to his supplier) on all the value supplied.\(^5\) This process is to ensure that taxable persons, being agents of collection, do not bear the burden of VAT except when they are final consumers of goods and services. It is this credit or net-off process that makes VAT a tax on value added and distinguishes it from sales tax. The credit system is based on a logical assumption that taxable persons would be encouraged to collect VAT, if they are able to deduct their input tax compared to a situation where they are expected to remit the entire output tax and then apply for a refund.

The credit system should not be confused with the refund system, which is the focus of this paper. The credit and refund systems are interwoven in the administration of VAT. It is the process of crediting that sometimes, though not invariably, leads to a refund. In a normal credit system, a taxable person remits or pays something to the government, no matter how little, being the excess of his output tax over input tax. However, in the case of a refund, a taxable person is entitled to claim whatever is the excess of his input over the output from the government.\(^6\) Unless the refund system is put in the proper perspective, it might appear, to a cursory observer, as an avoidable revenue loss for the government. For instance, the rationale for “paying” an agent of collection may be questioned. If the agent has nothing to remit to the government should the

\(^5\) See generally sections 10-13 VAT Decree.

\(^6\) Section 13(1)(a)-(b).
government not be left alone? If the gods cannot improve somebody's lot should they not leave him the way they met him rather than worsening his situation? It suffices to say at this stage, however, that it is naïve, wrong and myopic to view the refund system in this way. The system is a unique feature of VAT geared towards the efficient administration of the tax.

It is appropriate here to pause and consider the effect of refund on the revenue of the government.

1.3 Effect of refund system on the government's revenue

The refund system usually has a direct impact on the cash flow positions of both the taxable person and the government. If the system were to operate efficiently, a taxable person, being a mere collecting agent, should not bear any tax burden, except perhaps, the hidden compliance cost. For a taxable person to be fully relieved from the burden of VAT, all his inputs must be deductible and where the output tax exceeds input tax, refund must be made as quickly as possible. In this way, the entire tax burden would be shifted down the chain to the final consumer. The entire tax burden is borne by a final consumer because he has no output tax from which he can claim his input. This is the way a classical VAT operates.  

It has been contended that a cash refund system has no adverse effect on the government revenue. The illustration given in support of this contention is instructive:

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7 A proverb in the Western part of Nigeria.
9 The consumption variant of VAT. It is the most popular and widely used by many countries of all the three variant of VAT. It is adopted by all the Organisation for Economic and Development (O.E.C.D.) nations that have VAT.
“If the price of cotton lint, thread, yarn, cloths and clothes are N1000, N1500, N1800, N2500 AND N3000 respectively, and we levy a tax of 5% at each stage...Let us assume that the thread maker sells at a loss for N900 (which is less than N1, 000 he paid for the cotton lint) and the clothes maker sells at a loss for N1, 500 (which is less than N1, 800 he paid for the yarn) cash refund will be required as two stages in the chain as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Selling Price</th>
<th>VAT Collected</th>
<th>VAT Remitted</th>
<th>Cash Refund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cotton</td>
<td>100</td>
<td>50</td>
<td>50</td>
<td>-</td>
</tr>
<tr>
<td>Thread</td>
<td>900</td>
<td>45</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>Yarn</td>
<td>1800</td>
<td>90</td>
<td>45</td>
<td>-</td>
</tr>
<tr>
<td>Cloth</td>
<td>1500</td>
<td>75</td>
<td>-</td>
<td>15</td>
</tr>
<tr>
<td>Clothes</td>
<td>3000</td>
<td>150</td>
<td>75</td>
<td>N170</td>
</tr>
</tbody>
</table>

In the above illustration, it could be seen that there are two refund claims of N5 and N15 by the thread maker and the clothes maker respectively. The thread maker paid an input tax of N50 to the lint maker. He needed to recoup this. But he was able to collect only N45 output tax because he sold at a loss. The shortfall of N5 has to be refunded by the government. This refund will restore the tax on sale at the stage to N45, which is 5% of N900.

Similarly, the cloth maker who has bought yarn for N1800 was only able to sell his clothes for N1500. Therefore he could only collect an output tax of N75 which was N15 short of the tax of N90 he paid to the yarn maker. The tax paid to the government at this stage must be restored to N75, which is 5% of the selling price of N1500. So N15 which was the excess of the tax in the government’s hands must be refunded.

The total remittance to the government is N170 while cash refund by the government amounted to N20. The tax retained by the government is still N150, which is equal to 5% of the consumer price of N3000. Where there is excess of input tax over output tax the taxpayer can apply for cash refund or wait for the following month to take credit for the difference.”

11 Ibid.
With due respect, it will be presumptuous, in our view, to assume that a cash refund system will invariably always have a have neutral effect on the revenue of the government as indicated above. This is possible if, and only if, the claims (for refund) at the two stages were bona fide, otherwise a reduction of the government revenue will be inevitable. Hence, it becomes expedient for governments to protect the refund system against abuses in order to ensure that improper claims are not granted. Due the problems and prospects of abuses, the tendency in developing economics like ours is to design VAT in such a way that the circumstances that can lead to refund are curtailed or minimised.

2. The genesis of the refund controversy

At the preparatory stage taxable persons were assured that a VAT Refund Account had been opened with the Central Bank of Nigeria where definite monthly provisions were made to take care of verified refund claims.\textsuperscript{12} There was however no definite provision to that effect in the VAT Decree. Rather, section 13 of the Decree simply provides that:

13-(1) A taxable person shall, on rendering a return under subsection (1) of section 12 of this Decree –
(a) If the output tax exceeds the input, remit the excess to the Board; or
(b) If the input tax exceeds the output tax, be entitled to a refund of the excess tax from the Board on production of such documents as the Board may, from time to time require.\textsuperscript{13}

Going by the literal interpretation of this provision, a taxable person should be entitled to claim all his input tax which is loosely defined in section 10 as "the tax paid by a taxable person to his supplier on the

\textsuperscript{12} See J.K. Naiyeju, op. cit. p.101.
\textsuperscript{13} Section 13(1) VAT Decree.
taxable goods and services purchased by or supplied to him”.\textsuperscript{14} The question then was whether the tax was paid on “goods and services purchased or supplied by him?” Once the answer is in the affirmative, the tax would be deductible under section 13.

The permissive nature of the refund system opened a floodgate of applications. In order to curb possible abuses, the Federal Inland Revenue Services initially set the guidelines and requirements for claiming refund in an Information Circular.\textsuperscript{15} The circular stated that there were three ways of claiming refund, (i) the credit method, (ii) the direct cash method and (iii) a combination of both methods. The order in which the methods were arranged was, at least indicative of the preference of the FIRS. As a matter of fact, the circular categorically stated that “unless a taxable person indicates, his preference for cash refund in writing, the FIRS would presume a preference for the credit method.”\textsuperscript{16} The practice of subjecting refund applications to the verification by VAT auditors was regarded as evidence of the insincerity of the government to honour refund claims. It was argued, for instance, that the enjoyment of certain rights under the VAT system should not be dependent on the fulfillment of any obligation under any other tax systems. As convincing as this argument may seem, it is against the normal practice of set-off in the settlement of any claim. It is improper, in our view, for the FIRS to scrutinise the tax records of the claimant not only to ascertain the authenticity of the claim but also ensure that the claimant has no outstanding tax liability to the government before any claim is honoured. It will be recalled that this is one of the reasons why the administration of VAT was vested in the FIRS and not an autonomous agency as suggested by the proponents of the Modified Value Added Tax (MVAT).

While the practice of granting credit instead of cash refund will undoubtedly safeguard the revenue of the government, it is submitted that

\textsuperscript{14} Sections 10 and 42 VAT Decree.
\textsuperscript{15} See Federal Inland Revenue Service (FIRS) Information Circular No 9501, p.2.
\textsuperscript{16} Ibid.
is inconsistent with the express provision of the VAT Decree. Although the word “cash” refund was not employed by the Decree, the literal meaning of “refund” is “to pay back” or “repayment of money”. A refund cannot by any stretch of imagination be said to include a credit system. Therefore, the FIRS had brazenly ‘annulled’ the express statutory provision of the Decree and abridged the rights of taxable persons. The act, no matter, how altruistic the motive may be is ultra vires the FIRS. The correct approach would have been to formally amend the VAT Decree to incorporate a credit system. It is unfortunate that this was not done in 1998 when the provision relating to the refund system was amended. Rather, the focus of the amendment was to define the scope of allowable and unallowable inputs. Section 6 of the Finance (Miscellaneous Taxation Provisions) Decree, which introduced the amendment states as follows:

“13(A)-(1) for purpose of Section 13 (1) of this Decree, the input tax to be allowed as a deduction from output tax shall be limited to the tax on goods purchased or imported directly for resale and goods which form the stock-in-trade used for the direct production of any new product on which the output tax is charged”.

Subsection 2 expressly disallows the deduction of VAT on certain goods and services thus:

“(2) Input Tax:

(a) On any business, service and general administration of any business which otherwise can be expended through the income statement (profit and loss accounts) and

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17 See A.S. Hornby, Oxford’s Advanced Learner’s Dictionary of Current English, 11" impression, p.708
18 Decree No 18, 1998.
(b) On any capital item and asset which is to be capitalized along with cost of the capital item and asset, shall not be allowed as a deduction from output tax. ¹⁹ (Emphasis supplied).

Before considering the meaning and scope of the entire provision, it is remarkable that the opening paragraph of section 13(A) is clumsy and riddled with too much repetition. For instance, “goods purchased or imported directly for resale” and “goods which form the stock-in-trade” mean the same thing. It would have been better if one of the phrases were used instead of the two. Also, it is crystal clear that a word is missing in the phrase “goods which form the stock-in-trade used for the direct production of any new product”. How can goods be used for the ‘direct production of another product’ and yet be called be stock-in-trade? It is commonplace that ‘stock-in-trade’ is not a raw material or input for the production of another goods, rather used for direct reproduction of other goods. Where it is, it is no longer a stock-in-trade but raw materials. The phrase will however be meaningful if the word “or” is inserted between “stock-in-trade” and “used”. That way it would mean that input tax would be deductible if it is paid on goods, which form the stock in trade or used for the direct production of a new product.

Although the Finance (Miscellaneous Taxation Provisions) Decree 18 was signed into law on the 30th day of September 1998, the commencement of the above provision was back-dated to 1st January 1997 ²⁰ contrary to the principle of non-retroactivity. ²¹ A taxpayer should be able to make tax-planning decisions with knowledge of the regime of the tax law at the time of the time of the transaction. It is unfair to amend the law in such a way that raises the tax liability of a taxpayer beyond the limit when the transaction was made.

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¹⁹ Section 13 A (1)&(2) VAT Decree.
²⁰ Section 23 Finance (Miscellaneous Taxation Provisions) Decree No 18, 19998
²¹
3. Circumstances that may lead to credit balance

The "value added" being an incremental value on the goods and services at different stages of production and distribution,\(^{22}\) it is reasonable to expect that output tax will almost always exceed input tax.\(^{23}\) Therefore, in ordinary cases, a taxable person ought to have and usually has a higher output tax than input tax. However, there are certain circumstances that may give rise to a credit balance. Some of them are of temporary nature while, some are of permanent nature. We shall consider here the various circumstances that may lead to credit balance and how they are treated under the VAT Decree. The governing provision is contained in section 13(A). Attempt will also be made to show the approaches adopted by some other countries in dealing with the situations.

### 3.1 Capital Assets

A credit balance may arise where a taxable person has purchased a capital asset or assets. In such a circumstance the input tax paid on the asset may be so huge compared to its output tax to allow complete set-off.\(^{24}\) For instance, where a taxable person with an average monthly output tax of N50, 000 purchases a capital asset of N10 million. If the input tax on the capital asset alone is to be deducted from his output tax, then it would mean that the taxable person will not remit any tax to the government that month. Rather, he will be entitled to a refund of N500, 000. And where the credit system is used, the balance of the input tax would be relieved gradually for the next nine months.

Basically, there are three approaches to the treatment of VAT on investment on capital assets depending on the variant of VAT adopted by a particular country. Under the Consumption Approach, input tax on all capital assets is deductible at once upon acquisition from the output tax.

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\(^{22}\) For the definition of VAT see J.K. Naiyeju, op. cit. p. 27.

\(^{23}\) See FIRS Information Circular, op. cit., p.2.

\(^{24}\) A. A. Tait, op. cit., p. 286.
This is obviously the most advantageous to the taxable persons. The approach however ignores the enduring benefits of the asset over a long period of time and also distorts the cash flow of revenue of the government throughout the refund period. The Income Approach attempts to overcome the shortcomings of the consumption approach by allowing the input tax on capital assets to be amortized, through gradual claims, over the expected lives of the capital assets. The third, which is the Gross-Product Approach, does not allow the input tax to be set off against the output tax. Rather, the input tax is added to the cost of the assets while capital allowance is claimed on the total cost.

The VAT Decree does not expressly proclaim to adopt a particular type of VAT. It however provides in section 13(2)(b) thus:

13 (2) Input tax—
(b) on any capital item and asset which is to be capitalized along with cost of the capital item and asset, shall not be allowed as a deduction from output tax.

The provision is however generally regarded as codifying the Gross Product Approach whereby the taxable person is allowed to capitalise the capital asset and claim capital allowances on it under the Income Tax. According to a tax administrator:

By the provisions...the input tax disallowed is to be added to the cost of goods and services and claimed through the profit and loss

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25 J.K. Naiyeju, op. cit., p. 52
26 This is the approach in Russia and some other states of the former Soviet Union. See V. Thuronyi, op. cit., p. 222.
27 Ibid.
28 Section 13(2)(b) VAT Decree.
accounts. In the case of capital assets, it will be added to the cost of the capital item and claimed through capital allowances.29

If the above statement indeed represents the intention of the provision of section 13(2), it is submitted that this is not clearly expressed as such. In our view, the phrase “which is to be capitalised along with cost of the capital item and asset” in the provision has muddled up the relationship between the VAT Decree and the Companies Income Tax. It is inappropriate, in our view, for the VAT Decree to regulate the adjustment of chargeable tax under another tax system. A better approach would have been to amend the Companies Income Tax Act, by including the input tax on capital goods, as one of the deductible expenditure under the Act. The provision could have been meaningful if input VAT on capital asset were already deductible under the Income Tax as part of the capital allowance. However, this is not so, as there is no provision in Companies Income Tax Act, which specifically allows the deduction of input tax on capital assets as part of capital allowance. Even if there were any such provision, they will only be available in respect of qualified assets and not all capital assets as section 13(2) purports to do. The effect of the foregoing therefore, is that, the present deduction of input tax on capital asset, in practice, as part of capital allowance is a matter of concession and not law.

3.2. Administrative Overheads

A taxable person will normally incur administrative overheads on items such as electricity, telephone, stationery, payment for the services of professionals like lawyers, accountants, inter alia, in the day-to-day running of his business. The question is whether the VAT paid on such goods and services are deductible from their output tax. Going by the theory of classical VAT, there is no reason why such input taxes should

not be allowed in as much as they were incurred in the course of producing VATable goods and services. However, the FIRS has been disallowing such input taxes and thus treating taxable persons as the final consumers of such goods and services. Section 13(A)(2)(a) VAT Decree has now expressly made input tax on administrative goods and services non-deductible. The provision is reproduced hereunder for ease of reference:

13(2) Input tax:
(a) on any business, service and general administration of any business which otherwise can be expended through the income statement profit and loss accounts, and...........
(b) ....................................................
shall not be allowed as a deduction from output tax.30

A literal interpretation of the above provision would reveal certain ambiguities about its scope and effect. It is arguable that under this provision, only the input tax which are already deductible as expenses under the Income Tax statutes are disallowed under VAT, perhaps to guard against granting double relief in respect of the same transaction. This is in view of the phrase “which otherwise can be expended through the income statement profit and loss accounts”. Does it then mean, by necessary implication, that certain input taxes would be allowed if they are not deductible as expenses under the profit and loss account? But could this have been the intendment? It is instructive to note that it is the PPTA, which expressly permits the deduction of taxes, in its section 10(1) (h), which provides:

10(1)......There shall be deducted all outgoings and expenses wholly, exclusively and necessarily incurred, ...including.........

30 Section 13(A)(2)(a) VAT Decree.
(h) all sums, the liability of which was incurred by the company during that period to the Federal Government or to any state or Local Government council in Nigeria by way of duty, customers and excise duties, education tax (other than tax imposed by this Act) or any other rate, fee or other like charges.\(^{31}\)

The CITA and PITD have no corresponding provision. How then can the input VAT incurred by a taxable person be allowed under CITA and PITD in the absence of such provision? In practice however, the provision of section 13(2)(a) of the VAT Decree is generally regarded as permitting the deduction of such input taxes as expenses under the Income Tax.\(^{32}\) If this is the intention of the provision, it is submitted that the phrase “which otherwise can be expended through the income statement profit and loss accounts” only serves to becloud the issue and therefore should be deleted from the provision. There is also the need to enact a provision similar to that of section 10(1)(h) PPTA in the PITD and CITA. This is necessary to provide a legal basis for what obtains in practice otherwise deductions of such input taxes under CITA and PITD would continue as a matter of concession and not law. However, the long-term solution that will conform to the universal practice of VAT will be to allow the deduction of input taxes on administrative overheads.

3.3 Zero-rated goods

A common approach to VAT is to grant exports a zero-rated status pursuant to the destination principle. If goods and services are taxed at zero-rate, then the suppliers will be entitled to claim repayment of their inputs notwithstanding that they do not collect any output tax. Consequently, the input VAT of such suppliers will perpetually be outstanding. In some countries,\(^{33}\) exporters are allowed to use their

\(^{31}\) Section 10(1)(h) PPTA.

\(^{32}\) I.A. Zukogi, op. cit. p.9.

\(^{33}\) Such as Dominican Republic.
balances against other tax liabilities, such as income tax. In some others they are sometimes allowed to claim their input tax in anticipation of exports. 35

Whereas all imported goods and services were specifically made liable to tax at the inception of VAT in Nigeria, exported goods were neither specifically exempted nor taxable in any of the then existing tax schedules. 36 However, concession was granted in respect of export goods and services by according them zero-rated status. Naiye explained the basis for the concession thus:

The practice is to enhance a nation's competitive advantage in international trade. VAT is a domestic tax which should not affect export goods and services... 37

Within a short time, the FIRS became inundated with refund applications arising from imports that it had to rethink the concession. Zukogi explained the situation thus:

The FIRS has to be inundated (sic!) in the past with a deluge of VAT refund application arising from input taxes incurred on the production of exported goods. This was generally rampant among the major oil producing companies who were noted for exports of petroleum products (sic). As mentioned earlier, the export is to subsidise the consumer our crude oil who are largely rich countries. The question which occurred to the government of Nigeria is whether it was necessary to subsidize the crude oil which in any case will make little difference to those foreign countries. On the other hand, the poor economy of Nigeria

34 Such as Chile.
35 The exporter is required to make a sworn return specifying when exports will be made and estimating the amount. If he cannot demonstrate that the export has been carried out within the period promised, he must reimburse the amount, adjusted for inflation plus 1 percent interest. See ibid.
36 See the three schedule to the principal VAT Decree
37 J.K. Naiyeju, op. cit. p.-
will suffer to the extent of the rebate granted which are in several billions of Naira annually.\textsuperscript{38}

Consequently, the VAT Decree was amended with effect from 1\textsuperscript{st} January 1995 in such a way that all exports were expressly accorded an exempted status. Section 35(d) of the Finance Miscellaneous Taxation Provision Decree,\textsuperscript{39} which effected the amendment, provides thus:

35. The schedule to the principal Decree are amended –
(d) In part I of the Schedule, as amended, by inserting immediately after item 3, the following...item, that is -

“8. All exports”,

(e) In part II of the Schedule, as amended, by inserting immediately after item 3, the following new item, that is -

“4. All exported services”\textsuperscript{40}

The above provision, which gave a blanket exempted-status to exports, is an exception to the international practices of VAT and to that extent remarkable. From the statement of Zukogi, it is clear that the concession was withdrawn because of the mono-cultural nature of our economy and the inelasticity of the demand for the country’s oil in the international market. While it is certainly not fiscally prudent for the country to continue with the zero-rated policy as far as oil is concerned, this cannot be said of other products where the country has comparative disadvantages in the international market. A blanket withdrawal of the concession is bound to have a deleterious effect on the development of a sustainable international market for the agricultural products such as cocoa, palm oil, rubber and a few other manufacturing products. Against

\textsuperscript{38} L. A. Zukogi, op. cit. p.15.
\textsuperscript{39} Decree No 31 of 1996.
\textsuperscript{40} Section 35(d), Ibid.
this background, it is submitted that the blanket exempted-status given exports is counter productive for the good health of the Nigerian econon in the long run. The government should consciously use the VAT syste in deserving cases to encourage the exportation of some primary or secondary products in order to broaden the base of the country’s econon and lessen its dependence on oil.41

3.4 Exempted goods and services

Exempted goods and services also pose some problems associate with refund. Since suppliers of exclusively exempted goods and service do not collect VAT, they will have no output tax from which they could deduct their input tax. They are therefore faced with the choice of shifting the burden (either partly or fully) to the final consumer in form of highe prices.

3.5 Multiple Registration

Although section 8 simply requires a taxable person to register for VAT, which presupposes a single registration,42 the FIRS has, however directed that a taxable person who has more than one branch shoul register each branch separately. Thus a business entity is obliged, not as a matter of law but practice, to have a multiple registration and maintain independent records of its VAT transactions at each branch. This directive has been severely criticised as imposing avoidable hardship on affected taxable persons.43 In some companies, the head office may be responsible for the procurement of all materials for the branches without making any sales and therefore entitled to a large VAT refund. On the contrary, the branches that are making sales without procuring materials would be have

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41 The Nigerian economy is largely dependent on oil. For instance, out of the federally collectible revenue=====
42 Section 8(1).
43 R. O. Ojukotola, op. cit., p.-
a large output VAT without an opportunity to set-off input taxes from the head office. Whereas, if all the transactions were to be done centrally, the company would have been in a position to set-off some of the VAT being paid by its branches against the large refund position of the head office to reduce its entire VAT liability. Perhaps, the solution pending the review of the provisions would be for the affected taxable person to decentralize the purchases of their inputs, as much as possible, instead of bearing the burden of unfunded credit balance of the head office.

3.6 Non-Resident companies

Section 8B imposes VAT on non-resident companies carrying on business in Nigeria. Such companies are required to pay VAT through the person with whom they have a subsisting contract in Nigeria, presumably their agent or person(s) purchasing goods or requiring services from the non-resident company. Where a non-resident company has suffered input tax, there is no reason why it should not be allowed to deduct it from the output tax withheld in Nigeria. This is more so when Section 13, which regulates the processes of remitting the VAT liability, makes no distinction between resident and non-resident companies. Regrettably, the practice in Nigeria is to require the “agents” of non-resident companies to fully remit their VAT withheld by them without giving them the opportunity to deduct their input tax.

3.7 Government Contractors

44 Ibid.
45 See section 8 (B)(1) VAT Decree.
46 See section 8 (B)(2) VAT Decree.
Government Ministries and Parastatals also act as VAT collectors. However, contrary to the general collection procedures, Ministries and Parastatals are required to “withhold” the requisite VAT and remit it to the FIRS. The problem created by this arrangement is that the suppliers are robbed of the opportunity to deduct their input VAT. In such circumstances, contractor deals exclusively with government establishments may be persistently fiscally sustainable with a huge credit balance.

3.8 Compliance Costs

Being an indirect tax, VAT is not paid directly by the consumer to the tax authority. Rather, it is paid through the registered persons called “taxable persons” who act as collecting agents. The consequence of this is that the hidden compliance cost of administering VAT will fall on the final consumer but the registered persons. In certain circumstances, the administration of VAT by taxable persons may involve a lot of paperwork, such as keeping of accounts, invoices, receipts, cheques, filing of registration, delisting, return and assessment forms among others. Sometimes, taxable persons may even engage the services of accountants or account clerks to handle his VAT transactions depending on the size and nature of his business. Compliance costs do not qualify as input tax and are not deductible under s.13. This is not peculiar to VAT as compliance cost is not deductible under the Personal Income Taxes. The burden of the compliance costs may however not be significant if it is considered against the background that they also benefits from the cash-flow advantages arising from it.
opportunity to keep the output tax collected for some time before they are remitted to the tax authority.

3.9 Losses

A taxable person who has sold at a loss may suffer a "double jeopardy" if the input tax paid by him is not refunded. Section 13 does not specifically allow or disallow the input tax paid on goods sold at a loss. Consequently, going strictly by the provisions of the Decree, there is no reason why input tax incurred on losses should not be deductible if the conditions prescribed in section 13(A)(1) are satisfied. In practice, the FIRS allows taxable persons to add the input tax to their loss relief under the Income Tax. In our view, this middle way approach is preferable than an outright denial of any relief. It is, however, sensible, that necessary amendments should be made to the Income Tax statutes in such a way that will give a legal backing to what obtains in practice. This is because what are claimable under section 56 of PITD and section 227CITA are losses, which are quite different from taxes.

3.10 Bad Debts

VAT does not recognise credit sales since the tax is "charged and payable on the supply of taxable goods and services". If goods are sold or services are rendered on credit, the supplier is obliged to ensure that the requisite VAT on the goods are collected in advance and remitted to the

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32 D. Williams, op. cit., p. 221.
33 Colloquial for double loss or punishment.
34 See section 13(A)(1) VAT Decree.
35 See section 56 PITD.
36 See section 27CITA.
37 See section 27 VAT Decree.
tax authority.58 Occasions would frequently arise when output tax
been remitted in advance to the tax authorities, but payment for the g
and services is not received until much later. In the extreme cases w
the debt has become bad the payment will not be received at all.59

While some countries provide an allowance for bad debts,60 it
is a counter argument that suppliers usually take the risks of bad debts
account in determining their prices.61 In our view, input tax on goods
at losses need not be deductible in Nigeria except in circumstances w
the causes of the losses are fortuitous and palpably beyond the control
the taxable person. Otherwise, some unscrupulous taxable persons
fraudulently claim the “VAT loss relief” in order to reduce their liabili
It is better to allow such input tax on losses to be added to
general trading losses of the taxable person and relieved under his Inc
Tax. Towards this end, it will be necessary to also amend the provisi
PITD62 and CITA to specifically allow input taxes on goods sold at lost

4. Related Offences

It is remarkable to note that there is no offence that is specific
aimed at penalising the abuses of the refund system in the VAT Dec
However, the Decree contains general offences under which persons r

58 Section 2 VAT Decree provides that VAT is payable on the supply of goods and
services. It does not matter whether payment of the consideration is postponed or not.
59 D. Williams, op. cit., p.221.
60 See section 11 of the Finance Act, 1990. The requirement of bad debt relief in U.K.
that the tax payer must have: (i) must have supplied goods or services on or after 1
April,1989; and (2) accounted for the VAT paid on that supply; and (3) written off the
whole or part of the consideration in his accounts: and (4) notified the debtor providing
specific details that a claim for bad debt relief was being made. In addition: (a) six
months must have elapsed from the date payment became due or the date supply,
whichever is the latter.
61 D. Williams, op. cit. p.221.
62 See section 36 PITD.
be penalised for general fraudulent conducts which may also apply to refund. These include the offences of using of false documents, failure to keep accurate records and accounts, aiding and abetting commission of offence under the Decree. There is no doubt that unlawful application for refund will amounts to the offence of evasion under the Decree which attracts a fine of N30,000 or two times the amount of the tax being evaded, whichever is greater or imprisonment for a term not exceeding three years.

5. Conclusion and recommendations

In this work, attempt has been made to explain the VAT refund system and the policy that underlies it. The prime reason is to ensure that a taxable person, who is an unpaid agent, does not bear VAT burden, except, when he is a final consumer of goods and services. We have examined some of the circumstances that may lead to refund. They include circumstances where a taxable person has purchased capital assets, or is dealing in zero-rated goods, or has suffered losses or incurred bad debts, among others.

The law and practice relating to refund in Nigeria seems to reveal a restrictive policy of over-protection of the interest of the government at the expense of the taxable persons. We have seen that the Nigerian VAT does not accord a zero-rated status to any goods and services, including exported goods and services, either as a matter of concession or law, as it is done virtually all over the world. While the policy can be said to be sound in respect of goods, such as crude oil, whose demand is inelastic, the same cannot be said of other locally produced goods for which the country is still trying to develop a vibrant export market. Also, input taxes

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63 Sections 21-33.
64 Section 21.
65 Section 29.
66 Section 32.
67 Section 22.
on administrative overheads and capital goods are not deductible under VAT Decree in Nigeria. Rather, they are treated as deductible expenses under Income Taxes. This is patently adverse to the cash-flow position of the taxable persons because of the time value of money. The implication of this approach is that deduction of input tax on overheads and capital assets are granted as relief under Income Taxes and not as of right under VAT. There is no doubt that this policy will impact mostly on the real sector, such as the manufacturing sector compared to the trading sector where the taxable person might have added mere ‘place and utility values. Hence, by this policy, the government may be indirectly undermining the development of the real sector and encouraging people to engage more in buying and selling. It is suggested that refund could be made on quarterly or bi-annual basis instead of making taxable persons to wait until when they are making their Income Tax return. Even if the amortisation of the input tax on capital goods were to continue under the Income Tax, it is suggested that the rate should be, at least, twice the rate of the capital allowance under the Income Tax.

Also, the flagrant disregard of the refund provision has been criticised. Whatever may be the value of the present practice of granting credit instead of a cash refund, it has no basis in law until the VAT Decree is amended to expressly provide for it. If the taxable persons had been conscious of their rights and the need to defend them, they could have applied to the court for an order of mandamus to compel the FIRS to honour the refund provision of the Decree.

Concerning the recent amendment to section 13 of the VAT Decree, the palpable ambiguities contained in the provisions have been discussed. We have seen that the literal interpretation of the provision does not tally with what obtains in practice. It is hereby suggested that the provision of section 13 (A) should be generally amended along the line suggested in this paper. More specifically, an offence should be created for fraudulently obtaining or seeking to obtain refund under the VAT Decree.
It will be observed that instead of bracing up to the challenges of proper administering of VAT, the VAT Decree, in a manner short of brinkmanship expressly disallow certain input taxes to the detriment of the taxable persons. Although, attempt has been made to accommodate the input taxes on business, service and general administration under the Income Tax vide s.13 (2) VAT Decree; there is yet no express stipulation to this effect under the PITD and CITA. We therefore have a situation whereby; the VAT Decree has amended the provision of PITD and CITA. That notwithstanding, it is inequitable to require taxable persons to wait until they are filing their income tax return before they can get credit for their input taxes.

In the final analysis, rather than shy away from its responsibilities, the FIRS should be able to use the information acquired during the administration of VAT to strengthen the administration of other taxes. The present position whereby the enjoyment of the right to refund or credit is postponed, even in limited circumstances allowed, until when the obligation to pay the income tax is due is prejudicial to the cash-flow position of taxpayers with genuine claims.