Taxation of International Shipping and Air Transport Companies in Nigeria

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Introduction

On August 21, 2023, the Federal Inland Revenue Service ("**FIRS**") released a public notice addressing the non-compliance of international shipping and airlines with extant tax laws. The notice was published further to the FIRS' 2021 circular on the taxation of international shipping and airlines and FIRS' 2021 public notice tax compliance by international shipping lines.

Through this notice, the FIRS requested that all international shipping companies operating in Nigerian territorial waters in whatever capacity (containerized, bulk cargo, fishing trawlers, crude oil or natural gas lifting vessels, dredging, survey, floating, production, storage, and offloading) to regularize their tax positions. All affected international shipping lines are required to conclude the regularization of their outstanding tax returned at the Non-Resident Tax Office of the FIRS no later than 31st December 2023.

In this article, we provide a wide-ranging overview of the taxation of non-resident companies operating in the shipping and air transport sectors in Nigeria. We consider the companies income tax, capital gains tax, and value added tax applicable to their operations.

Due to the peculiarities of the cross-border operations of international shipping and airline companies, their Nigerian tax liabilities may not be easily ascertainable and monitored. Consequently, there is a loss of revenue accruable to the Nigerian tax authorities from shipping and air transport operations. The Finance Act, 2023, in addressing this challenge, imposes stricter compliance obligations on such companies. The sector's regulatory agencies have also been employed in this compliance race to enhance the monitoring of these companies. We explore the additional obligations imposed by the Finance Act, 2023; if implemented, we think that these introductions can potentially drive increased compliance amongst shipping and air transport companies.

The Tax Obligations of Non-Resident Shipping and Air Transport Companies Operating in Nigeria

The key legal instrument is the Companies Income Tax Act ("**CITA**"), FIRS circular on the Taxation of Companies engaged in Shipping, Air Transport, and Cable Undertakings ("**FIRS Circular**") and the Double Taxation Agreements ("**DTAs**"). It sets out copious provisions to guide Non-Resident Companies ("**NRCs**") on their tax obligations as it relates to their activities in Nigeria. The company income taxation of non-resident shipping and airline companies can be broken down into two broad categories as follows:

1. Taxation under the Companies Income Tax Act

NRCs operating in shipping and air transport sectors whose home countries have no DTA with Nigeria are taxed under the CITA. CITA mandates such NRCs to pay tax based on the profits derived from their Nigerian operations.[1] CITA however makes important distinctions in the taxable derived income. First, the derived income to be taxed is freight income (from activities such as the carriage of passengers, mail, livestocks, or goods) as opposed to non-freight income from other business activities (including commission, demurrage, container clearing fees and stevedoring). Second, freight income earned from transshipment is exempted from taxes.[2] The profits assessable to tax are ascertained using the financial statement submitted by the company for its Nigerian operations.

However, the Federal High Court in a recent judgment has held that incidental non-freight income derived from Nigeria by foreign shipping companies is taxable under Section 9 of CITA at the applicable company income tax rate[3]. The Court established that incidental non-freight income should be

[1] Section 14(1), CITA.
[2] Section 14(1), CITA.
[3] *CMA-CGM Delmas SA v FIRS (FHC/L/1^A/2021).*

separated from inbound shipping income. Therefore, the incidental non-freight income does not constitute freight income and is subject to tax under section 9 of CITA.

CITA also makes provisions for the computation of taxes payable by these NRCs. Computation can be done in either of two ways:

a. Similar Material Basis

Where the tax authority of the NRC's home country computes and assesses tax on a basis not materially different from that applied under CITA and it certifies the ratio of profit or loss and the ratio of allowances by way of depreciation, these ratios shall be adopted in the computation of the companies' profit or loss for the year of assessment.[4]

b. Different Material Basis

Where the tax authority of the NRC's home country computes and assesses tax on a basis materially different from that used under CITA, the assessable profit of the NRC shall be determined as a fair percentage of the freight income derived in Nigeria. FIRS typically applies a taxable income percentage of 20% of profits in line with government policy[5].

Regardless of the applicable computation basis, the tax payable by an NRC for any year of assessment shall be a minimum of 2% of the freight income derived from Nigerian operations.[6]

2. Taxation under the Double Taxation Agreement

For NRCs whose home countries have a DTA with Nigeria, their tax liability is based on the provisions of the DTA's article on shipping and air transport. Generally, Double Taxation Agreements treat the taxation of profits of NRCs in shipping and air transport in two different ways:

a. Unconditional tax exemption

The first category is the DTAs that grant unconditional tax exemptions to international shipping or air transport companies of the tax treaty partner. These companies enjoy complete exemption from tax in Nigeria if they are residents of the specified treaty partner.

b. Conditional tax exemption

The second category consists of the DTAs that grant conditional tax exemptions. The treaty benefits provided to these companies depend on whether or not there is a reciprocity clause in the DTA. This reciprocity clause implies that Nigerian companies in shipping and air transport operating in international traffic call at the port of a treaty partner country and similar companies in the treaty partner country operate or call at Nigerian ports. Where there is a reciprocity clause, NRCs would not pay tax in Nigeria and the Nigerian companies will not pay tax in the corresponding treaty partner country. The profits of the shipping or air transport company will only be taxable in their respective home countries. However, this exemption is only limited to the activities specified in the DTA. However, where there is no reciprocity clause, the derived income of the NRCs will be taxed based on the rate specified in the DTA.

Applicability of Withholding Taxes

NRCs that provide services in Nigeria will be subject to the payment of withholding taxes in line with section 81 of CITA and the Withholding Regulations. NRCs are liable to tax on "all contract and agency

[4] Section 14 (2) CITA.
[5] FIRS Information circular on taxation of companies engaged in shipping, air transport and cable undertakings.
[66] Section 14(4) CITA.

arrangements." The Nigerian company or person to whom such service is rendered in Nigeria is required to deduct the tax at source and remit the same to FIRS.[7]

For NRCs from treaty countries, the applicable WHT rates are as specified in the respective tax treaties. The WHT rates commonly agreed to range from 7.5% to 10%.

The Tax Appeal Tribunal in *Kenyan Airways v FIRS*[8] ruled that Kenyan Airways is subject to Value Added Tax ("**VAT**") and withholding tax liabilities. Also, companies engaged in domestic shipping or air transport will be liable to tax (including withholding tax) on their profits in Nigeria.

Withholding tax ("**WHT**") is deducted and remitted in the currency of the transaction. For passive income (such as dividends, interests, royalties, or rents), withholding tax is the final tax paid by NRCs.

Taxation under the Capital Gains Tax Act

Irrespective of the location of the ship or aircraft at the time of the disposal, a ship or aircraft used in international traffic is situated in Nigeria, where: (i) the owner of the ship or aircraft is resident in Nigeria, or (ii) a person resident in Nigeria owns an interest in or right over the ship or aircraft.[9] Thus, gains from the disposal of such ship or aircraft or the right or interest in the ship or aircraft are chargeable to capital gains tax in Nigeria, even where the ship or aircraft is not physically in Nigeria at the time of the disposal.

A ship or aircraft not used for international traffic (*e.g.*, a rig, an intra-Nigeria transport, lift boat, or stationary restaurant, hotel, and other uses) located in Nigeria shall be treated as tangible moveable property, and the disposal of such ship or aircraft is chargeable to capital gains tax in Nigeria, irrespective of whether or not the owner is resident in Nigeria or whether or not the disposal took place in Nigeria.[10]

Where the ship or aircraft is owned by a non-resident, even where the ship or aircraft is located in Nigeria at the time of disposal, the gains from the disposal will not be taxable in Nigeria.[11]

However, where there is a DTA, a non-resident will only be subject to CGT in Nigeria where the aircrafts/vessels are not used in international traffic and the aircrafts/vessels are located in Nigeria at the time of the disposal and constitute permanent establishments ("**PE**") for the non-residents.[12] It is pertinent to note here that where the owner of the ship or aircraft or the person who has an interest in or right over the aircraft is a resident of both treaty countries, the "tie-breaker" rule will be applied to determine the residential status for tax purposes. The tie-breaker rule involves first considering the permanent home of the individual. Where that does not break the tie, the center of vital interest will be considered, and where that does not break the tie, the habitual abode and nationality are considered successively. Where these do not break the tie, the residential status will be decided by mutual agreement.

Taxation under the Value Added Tax Act

The Value Added Tax Act[13] requires NRCs in the shipping and air transport sector to remit VAT on services provided in Nigeria. The VAT will be withheld by the Nigerian resident or company and remitted to the FIRS. Services consumed or otherwise utilized in Nigeria are subject to VAT in Nigeria.

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[7] FIRS Circular on Taxation of Non-Residents in Nigeria dated June 3, 2021.

[8] TAT/LZ/CIT/017/2015.

[9] The FIRS Circular on the provisions of the Capital Gains Tax Act dated June 3, 2021.

[10] Paragraph 9.1.2, the FIRS Circular.

[11] Paragraph 9.1.1, the FIRS Circular.

[12] Paragraph 9.1.2 of the FIRS Circular.

[13] Cap V1, LFN, 2004 (as amended).

NRCs are required to register with FIRS and obtain a Tax Identification Number ("**TIN**") and must include VAT on their invoice for the supply of services.

Also, VAT is chargeable on income from ancillary services provided by NRCs in the shipping and air transport sector in Nigeria.[14] Income from ancillary services includes demurrage and detention, local charges, stevedoring, clearing, and forwarding, cargo handling, container leasing, storage, agency, and so forth. VAT must therefore be charged and remitted in accordance with the extant tax laws.

Filing Obligations and Changes Introduced by The Finance Act, 2023

Regardless of whether an NRC is taxable under the DTA or CITA or granted an unconditional exemption, it still has the obligation to file their annual tax returns with the FIRS[15].

The Finance Act, 2023, imposes an additional obligation on non-resident shipping and air transport companies. Where such companies file their tax returns but do not provide a separate financial statement of their Nigerian operations, the company is obliged to submit detailed gross revenue statements of its Nigerian operations. The statement should show the amount of full sums earned during the period to be certified by one of the company's directors and an external auditor. This statement is to be submitted together with all invoices issued to relevant customers.

The Finance Act also imposes an obligation on regulatory agencies in the shipping and air transport and other relevant sectors to request (a) evidence of income tax filing for the preceding tax year and (b) a tax clearance certificate showing the incomes paid for 3 preceding tax years before granting any relevant approvals and permits. NRCs must ensure the submission of these documents in order for the target to continue doing business in Nigeria.

Impact on Foreign Investment

The amendment by the Finance Act, 2023, has several implications for foreign investment. The additional compliance requirements and potential administrative complexities may make some foreign investors hesitant to enter the Nigerian shipping and air transport market. The newly-introduced tax obligations may be perceived as an additional burden on companies operating in these sectors.

Foreign investors may assess the feasibility of operating in Nigeria considering these additional tax-related obligations. The amendment will also result in increased compliance costs and potential operational activity restrictions. This would have an impact on investment decisions.

Conclusion

This Finance Act, 2023 which imposes tax obligations on NRCs in the shipping and air transport sector seeks to ensure transparency and accountability on the part of the NRCs. The Finance Act, 2023, also enhances revenue generation from the shipping and air transport sector. Accordingly, the tax authorities can effectively monitor the financial activities of NRCs more effectively. This will create a level playing field for both domestic and foreign companies, ensuring that everyone contributes their fair share of taxes. The newly-introduced provision in the Finance Act, 2023, will reduce tax evasion, money laundering and other illicit activities. The amendment will serve as a deterrent for non-compliance by NRCs. The risk of operational restrictions or approval denials provides a strong incentive for companies in these sectors to fulfil their tax obligations.

It is important that while sourcing revenue from taxes, there should be a balance between the pursuit of tax revenue and promoting a favourable investment climate. The Nigerian Government is enjoined to explore utilizing tax and other fiscal measures to generate revenue that will foster Nigeria's economic stability and simultaneously attract foreign investment.

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[14] Paragraph 8.1 of the FIRS Circular.

[15] Section 55, CITA.

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