

DEVELOPMENTS IN THE OIL & GAS SECTOR

Withholding of VAT on oil service contract payments at source.

The Federal Inland Revenue Service (FIRS) issued a directive at the beginning of 1997 requiring local oil exploration and production companies to withhold the Value Added Tax (VAT) component of invoices of non-resident service contractors. The withheld VAT was to be paid directly to the Revenue. The directive was stated to be with retrospective effect from 1st January 1997.

The FIRS directive is actually implicit in the provisions of the Finance (Miscellaneous Taxation Provisions) Decree of 1996. Though apparently signed into law on 23rd October 1996, the Decree became available to members of the public at the beginning of the second quarter of 1997.

Government had in the past repeatedly alleged that most (non-resident) service contractors doing business in Nigeria charge VAT on their invoices, but fail to remit same to the Revenue, thereby defrauding Government. The new Decree and the FIRS directive constitute Government's attempt to remedy the situation and improve on VAT collection.

Despite initial resistance rooted in concerns over the legal status of the directive, it would appear that E & P companies began to implement the directive in earnest by the third quarter of 1997. Since then, (non-resident) service contractors have suffered substantial deductions on current invoice values, as E & P companies attempt to recover the VAT component of all (non-resident) contractors' invoices paid since 1st January 1997.

The scale of deductions and the impromptu manner in which they have been effected has elicited much protest from affected contractors. Unfortunately the E & P companies are actually being held liable by the Revenue to account for the VAT component on their contractors' invoices, hence the deductions have continued unabated. Contractors who actually complied with VAT regulations by remitting the VAT component on their invoices to the Revenue as and when due, are particularly piqued, as implementation of the Revenue directive results in a double charge of VAT on their invoices. The Revenue, when issuing its directive, obviously failed to take the latter cases into account.

The Revenue's directive has more long-term implications than are immediately apparent. Nigeria's VAT scheme requires service contractors to render VAT returns monthly. The standard VAT returns form has separate columns showing total contractual income (i.e. VATable income) for the month, VAT paid on contractor's local purchases (i.e. input VAT) and VAT component on contractor's invoices for the month (i.e. output VAT). Input VAT is normally netted off against output VAT in order to arrive at the total VAT due to the Revenue monthly. If input VAT exceeds output VAT, then the contractor is, in theory, entitled to a refund.

The Revenue's directive has the nebulous effect of depriving the contractor of the bulk of his output VAT. Since he has little or no output tax to fill on his VAT return form, he now has no means of recovering any portion of his input tax (as paid on his local purchases). We are not aware of any case, where the Revenue has made a refund to a taxpayer under Nigeria's VAT system. The contractor therefore runs the risk of being in a perpetual (monthly) refund situation in theory but unable to recover any refund! The practical effect is an increase in contractor's local cost structure, hence reduced profit on local operations.

VAT officials spoken to acknowledge the difficulties wrought upon non-resident contractors who observed VAT regulations, but still insist that E & P companies withhold contractors' VAT and pay same directly over to the Revenue.

We however are made to understand that on their part, the E & P companies are willing to assist contractors able to establish regular VAT remittance since 1st January 1997 by internal reconciliation of their accounts over the space of a few months.

We advise that non-resident contractors continue to complete and file VAT returns monthly in accordance with the VAT Decree, to insulate themselves against penalties under the Decree for failure to file VAT returns as and when due.

We also advise that contractors unable to file returns regularly, wholly or in part as a result of the Revenue's directive write officially to the Revenue, briefly explaining their circumstance as a result to the actions of their principals in line with the Revenue's recent directive.

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