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VALUE ADDED TAX AND THE **TELECOMMUNICATION INDUSTRY,** ISSUES AND CHALLENGES

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OVERVIEW OF TELECOMMUNICATION INDUSTRY

Data provided by the National Bureau of Statistics (NBS), provides that the telecommunications sector is the largest segment of the Information and Communications Technology (ICT) sector[1] contributing over USD75 Billion approximately 17% of Nigeria's Gross Domestic Product (GDP).[2]

The rapid growth of the telecommunications sector has positively impacted several other sectors of the Nigerian economy including but not limited to banking services (bank mobile apps), e-health, and e access to e-learning platforms for Nigerians. During the covid pandemic, the telecoms sector became a reliable ally for individuals, businesses, schools, and health organisations. It brought about a new normal in virtual meetings learning activities and health care delivery. Despite its growth and innovation, the Nigerian telecoms industry is not without its challenges which range from multiple taxation to over regulation, vandalism, theft, right of way fees, among others.[3]

On the issue of multiple taxation is the issue of Value Added Tax on telecoms goods and services. Value Added Tax (VAT) charged at the rate of 7.5% are to be paid by businesses operating in the Nigerian telecommunication industry on taxable goods and services consumed. They also have the obligation to collect and account for VAT on taxable supplies to their customers. The foregoing is based on the Value Added Tax Act, 2007 (VATA or the Act), as amended by Finance Act 2020 and Finance Act 2021, which requires VAT to be charged and paid on supply of all goods and services (except those specifically exempted by the Act).[4]

VAT is multi-layered as it is imposed at every stage of value addition in the transaction value chain, from production to ultimate consumption. Every supplier of any good and/or service liable to VAT is expected to include VAT on its invoice and collect the VAT, except the supplier is a small company who makes taxable supplies less than NGN25 million (US$29,411.76) in any calendar year. This VAT is regarded to as 'output VAT'. However, the exemption from VAT registration and subsequent compliance obligation applicable to small companies with annual turnover of less than N25m (US$29,411.76) does not apply to companies engaged in upstream petroleum operations regardless of turnover.

VAT incurred by a purchaser on goods qualifies as 'Input VAT'. Input VAT is deducted from the output VAT and the balance (net output) is paid to the Federal Inland Revenue Service (FIRS) within 21 days of the month following that in which the purchase or supply was made.

[1] See The Guardian Newspaper 21st September, 2021
[2] ibid
[3] ibid
[4] Section 2 Value Added Tax Act

Input VAT can be offset against output VAT in the following circumstances:

1. ***where the goods are purchased or imported directly for resale***
2. ***where the goods form the stock-in-trade used for the direct production of any new product on which the output tax is charged.***

Input VAT incurred on expenses that do not meet any of the above conditions and not recoverable against output VAT but are to be expensed through the income statement, if incurred on overheads, services and general administration or capitalised as part of the cost of the asset if incurred on fixed assets (property, plant, and equipment). In other words, only trading or manufacturing activities in relation to goods would qualify for an input VAT claim from output VAT.

The taxpayer is entitled to a VAT credit where the qualifying input VAT incurred is more than the output VAT received. While the above principle is established, there have been concerns about what constitutes qualifying input VAT claims. The Tax Appeal Tribunal (TAT), in the case of **CHI Limited v. The Federal Inland Revenue Service (FIRS)** resolved the controversies around the interpretation of Section 17 of the VAT Act, which provides the basis for qualifying input VAT claims. CHI Limited as an Appellant argued that the term "stock-in-trade" as used in Section 17 of the VAT Act was without any further definition and so cannot be construed strictly and restrictively to mean inventories alone. The company, argued that the term's ordinary meaning is more exhaustive than inventories and that items such as gas, spares and consumables used in the direct production of its products qualify as stock-in-trade in the context of Section 17 of the VAT Act.

The Tribunal ruled in favour of the Appellant that "stock-in-trade" could not be simplified to just raw materials and inventories. Since the VAT Act provides for "stock-in-trade", the same must be construed in its ordinary sense. The TAT further cited that in the absence of a legislative definition of the term, the Appellant was within reason to rely on the ordinary dictionary definition as the dictionary provides a sympathetic and imaginative discovery of legislative intention.

CHALLENGES OF THE APPLICATION OF VAT IN THE TELECOMMUNICATION INDUSTRY

There are several challenges operators in the telecommunication industry face regarding the application of VAT on their purchases and supplies. Some of the major challenges are as follows:

1. **Non-recoverability of input VAT from output VAT**

The non-recoverability of VAT incurred via the input-output mechanism is a major issue impacting cashflow and profitability in the telecommunications sector. Given the strict conditions for offsetting input VAT against output VAT, telecommunication companies are not able to recover the whole input VAT incurred on their purchases.

This is regardless of the fact that VAT is incurred on cost of service that forms part of the direct cost of the companies. This impacts cashflow as more cash is parted with monthly while annual profits are eroded due to the expenditure of input VAT to the income statement.

2. **Recognition of VAT on interconnect charges**

Network operators in the telecommunications industry usually pay interconnect charges for using other operators' networks to complete calls that originate from their networks but terminate in such other networks. The operator on whose network the calls originate charges the customers and pays the operator on whose network the calls terminate their share of the amount charged. These charges are usually inclusive of VAT. In practice, operators prefer to offset the VAT incurred on interconnect charges from output VAT charged to their customers for services provided. FIRS, in contrast, frowns at this practice and demands the full VAT on revenue earned from the customers, while insisting that the VAT incurred on interconnect charges be charged or expensed to the statement of comprehensive income.

CONCLUSION

The issues identified above are proof that there is still a wide gap between current business realities and the provisions of VATA. While businesses have continued to evolve, the tax laws have not been sufficiently reviewed to address new business exigencies and realities, notwithstanding amendments introduced by the Finance Acts 2019, 2020 and 2021.

Despite a low VAT rate of 7.5%, and year on year amendments since 2019, the VAT system and VATA in its current form, is unable to capture the evolution in the operations and business models of companies, including operators in the telecommunications industry.

The discriminatory provision in VATA as it affects the claim of input VAT in service industries creates a number of controversies. The service industries must be given the opportunity to claim input VAT in the same manner as companies operating in the trading and manufacturing sectors. There is therefore an urgent need to review and amend the VAT law to address the issues identified above.

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