



# EXAMINING THE FIRS CIRCULAR ON THE CHARGEABILITY OF VAT ON SERVICES PROVIDED BY FINANCIAL INSTITUTIONS

**V**alue Added Tax (VAT) is regulated by fiscal legislation in the Value Added Tax

Act CAP V1, LFN 2004 (as amended). VAT has however, not been defined by the Act. The Federal High Court in Nigeria per Hon. Justice Saliu Saidu in the case of SAIPEM CONTRACTING NIGERIA LTD & 2 ORS V. FEDERAL INLAND REVENUE SERVICE & 2 ORS 2014 15 TLRN 76 @ 98 defined VAT as a consumption tax charged on goods and services, it is payable by the consumer of taxable goods and or services. According to **Section 2** of the **Value Added Tax Act** (as amended), VAT is charged and payable on the supply of all goods and services in Nigeria other than those listed in the first Schedule of the Act. Amongst those services chargeable to VAT are the services rendered by Financial Institutions.

It is for this purpose that the FIRS issued Information Circular No: 2021/04 dated 31<sup>st</sup> March, 2021 and titled 'Value Added Tax (VAT) on Services of Financial Institution' (The FIRS Circular). The Firs Circular is subject and made pursuant to the provisions of the Value Added Tax Act (as amended) and as such we shall review relevant provisions of the Act. This Article shall also discuss the background to VAT on Financial Services, the Information Circular, and process of chargeability of VAT according to the information Circular.

## BACKGROUND

VAT is an indirect tax assessed at each step of value added in the production process of a commodity and deducted off the tax paid finally by the consumer. In Nigeria it is a tax that is proportional to the price of goods and services and in compliance with Section 4 of the Value Added Tax Act (as amended) the rate of VAT on the value of all taxable goods and services is 7.5%. VAT is administered in Nigeria by the Federal Inland Revenue Service (FIRS).

As stated earlier VAT is charged at every stage of production that involves the addition of value. It is collected and remitted by the supplier of the good or service in proportion to its margin i.e. on the VAT imposed on its taxed inputs and the VAT imposed on its taxed outputs. The tax liability is determined by the invoice-credit method permitting businesses in the production chain to deduct the VAT they pay on their purchases while accounting for the VAT they collect on their sales. Under the invoice-credit method, each business in the production chain charges VAT at the rate specified for each supply and passes to the purchaser an invoice showing the amount of tax charged. The purchaser is in turn able to credit that input tax against the output tax charged on its sales, remitting the balance to the FIRS and receiving refunds when there are excess credits. The claim to allowable input tax is regulated by **Section 17** of the **Value Added Tax Act** (as amended).

## APPLICABILITY OF VAT TO SERVICES RENDERED BY FINANCIAL INSTITUTIONS

VAT covers a wide range of goods but some goods and services are tax exempt. Some of such services in Nigeria are services rendered by Community Banks, People's Banks and Mortgage institutions. In fact most countries around the world have not brought services rendered by financial institutions such as banks into the VAT net. This is because banks and other financial institutions often bury their charges for financial services in margins including interest rate and currency conversions. This poses difficulties for an invoice-credit based method for determining VAT liability. If the value of financial services is to be taxed, the financial service provider must identify and value those services. However, some services provided by Financial Institutions are identifiable and carry express charges. In Nigeria, those services are liable to VAT under **Section 2** of the **VAT Act** (as amended by the Finance Act 2020) being a supply of services otherwise consumed or utilised in Nigeria.

Further to the rule on the applicability of VAT to only express charges, on the 31<sup>st</sup> March 2021 the FIRS published an information circular to provide clarification on the chargeability of Value Added Tax on Services of Financial Institutions.

## DEFINITION OF FINANCIAL INSTITUTION BY THE FIRS CIRCULAR

The FIRS circular incorporates the definition of Banks and other financial institutions in the Banks and Other Financial Institutions Act and thus defines financial institutions as any bank, individual, body, association or group of persons, whether corporate or unincorporated, licensed under Banks and Other Financial Institutions Act (BOFIA) 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.

Therefore this definition includes Banks, Insurance Companies, Discount houses, Pension Fund Administrators, Brokerage Firms, Mutual and Hedge Funds and other Investment Companies as part of Financial Institutions and thus the FIRS circular shall apply to all such institutions.

## INCOME OF FINANCIAL INSTITUTIONS LIABLE TO VAT

According to the FIRS Circular, return on investments are not liable to VAT as opposed to income from services that are consumed by a customer. Thus the following services that are rendered by the financial institutions are subject to VAT though the list is not exhaustive or conclusive:

- a) Commissions charged on forex trading or remittance;
- b) Commissions on sale of Bank drafts/certified cheques;
- c) Commissions paid to brokers, reinsurers, underwriters and other insurance agents by an insurer;
- d) Commission on asset trading;
- e) Account Maintenance Fees, ledger fees etc.;
- f) Legal and other fees chargeable on lease arrangements;
- g) Fees charged for advisory services e.g. mergers and acquisition, financial strategy counseling etc.;
- h) Fees chargeable on public/private issues;
- i) Debt conversion fees;
- j) Fees on asset trading;
- k) Fees earned on fund management;
- l) Fees earned on letters of credit/documentary collection to finance import/export;

- m) Fees chargeable on stock-brokerage and trust services;
- n) Fees charged on electronic banking, POS and ATM charges;
- o) Fees charged on electronic bill payments;
- p) Mobile money transactions and other like transactions.

Though services rendered by banks and other financial institutions are numerous, not all charges are liable to be paid by Customers save those approved by the Central Bank of Nigeria. This checks arbitrary and excessive charges by Banks and other financial institutions. All charges must comply with the Guide to Charges by Banks, Other Financial Institutions and Non - Financial Institutions issued by the Central Bank of Nigeria.

## INCOME OF FINANCIAL INSTITUTIONS EXEMPT FROM VAT

According to the FIRS Circular not all income from services rendered by the financial institutions are liable to VAT. The following incomes are not liable to VAT:

- a) Interest on loans and advances, including overdraft facilities;
- b) Interest on savings accounts;
- c) Interest on bank deposits;
- d) Interest on interbank placements;
- e) Premium on insurance policies;
- f) Dividends; and
- g) Profit or Gain on disposal of securities.

## REGISTRATION AND RETURNS BY FINANCIAL INSTITUTIONS

All Financial Institutions who fall under the definition above are required to register for VAT purposes with the Federal Inland Revenue Service and obtain a Tax identification Number. Such institutions are to file VAT returns at the relevant FIRS office within 21 days of the next month after a VATable transaction.

In filing returns, the relevant financial institutions shall comply with the provisions of **Section 17** of the **Value Added Tax Act** (as amended) which covers returns on input tax. Accordingly the circular stipulates further that:

- a) All input VAT payable on the purchase on assets should be added to the cost of assets on which capital allowances are allowed;
- b) Input tax suffered on goods supplied to customers shall be deductible from the output tax on those goods;

- c) VAT payable in respect of services consumed by financial institutions shall be regarded as part of operational expenses chargeable to statement of profit and loss account and should not be claimed or deducted from output tax collected.

## OBLIGATION TO CHARGE AND REMIT VAT

The obligation to charge and remit VAT to the FIRS generally lies with the Financial Institution who is supplying the goods or services. However, in arrangements where an agent or broker acts as an intermediary between the Financial Institution and the Customer the following shall apply:

- a) The obligation to charge and remit VAT shall be that of 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, the financial institution has the obligation to self-account and remit same to 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;
- 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.

## CONCLUSION

The FIRS Circular ushers a new era of administration of VAT on fees, commissions and charges of financial institutions that fall within the contemplation of the Circular. Again all such charges must be expressed to the customer before VAT can apply. Customers have a right to request for an invoice for such services. The FIRS Circular further states that the FIRS may withdraw, replace, amend or update the provisions of the Circular.

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