

# TNP Insights



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## Tax Appeal Tribunal holds that Leases on real property are not subject to Value Added Tax

### Issues for determination

In delivering its judgment, the TAT examined the following issues:

- (i) whether rental income is subject to VAT;
- (ii) whether the Federal Inland Revenue Service (FIRS) has the power to issue Information Circular 9701 which purported to subject rents on commercial property to VAT.
- (iii) The TAT held that the Information Circular 9701 issued by the FIRS is a mere opinion of the FIRS as to the interpretation of tax laws. It does not constitute a regulation within the meaning of the VAT Act and does not command the force of law.

### Decision

The TAT held as follows:

- (i) The VAT Act is silent on the definition of goods and services which forced the TAT to rely on the definition of “goods” in the Sale of Goods Act of 1893 which defines “goods” as chattels personal other than things in action, money and things attached to or forming part of the land. The TAT also relied on the definition of “services” as contained in the *Black’s Law Dictionary* as “an intangible commodity in the form of human effort such as labour, skill or advice.” According to the TAT, rent on commercial property does not constitute a good or service and therefore is not subject to VAT. The TAT further held that the expression, “the letting out of taxable goods on hire or leasing, and any disposal of taxable goods” contained in section 42 of the VAT Act (now Section 46) “must be construed by reference to goods properly so-called, that is, goods that are moveable or capable of being severed.” In essence, the FIRS cannot use the expression to bring every transaction within the ambit of the VAT Act, rather the expression must be construed as applying only to “goods” as defined by the Sale of Goods Act.

The TAT distinguished leases simpliciter from short-term leases and held that short term leases are subject to VAT because such leases include amenities/services

such as laundry, breakfast, entertainment thereby making such short term lease a service.

- (ii) The TAT held that the VAT Act (Modification) Order 2018 is null based on the decision of the Federal High Court in *HOMAL (suing for itself and on behalf of all its members) v The A.G., Federation & Anor (Suit No. FHC/L/CS/1082/2019)* delivered May 8, 2020. According to the TAT, Section 38 of the VAT Act which conferred the Minister with the power to amend the First Schedule to the VAT Act is null because it breaches the constitutional doctrine of separation of powers.

### Implications of this Judgment

This judgment is a restatement and an expansion of the principle espoused in *CNOOC v A.G., Federation & Anor (2011) 4 TLRN 185* where the Federal High Court held that intangible rights are not subject to tax under the VAT Act. In that case, the Federal High Court held that the interest held in a production sharing contract was not a “good” but an intangible right, therefore disposal of such interest is not taxable under the VAT Act. This judgment serves to reduce the tax burden which lease transactions in respect of real property would have been subject to by the FIRS.

It should be noted that Section 46 of the VAT Act as amended by the Finance Act 2019 has laid to rest the uncertainty regarding the definition of “goods”. It defines “goods” as “all forms of tangible properties that are moveable at the point of supply but does not include money or securities” or “any intangible product, asset or property over which a person has ownership rights, or from which he derives benefits, and which can be transferred from one person to another, excluding interest in land.” Therefore, the combined effect of the Finance Act 2019 and this judgment is that leases in respect of interest in land are exempt from VAT.

On 10th September 2020, in Appeal Number: TAT/LZ/VAT/029/2019, *ESS-AY Holdings Limited v Federal Inland Revenue Service*, the Tax Appeal Tribunal (TAT) held that rent on real property is not subject to value added tax (VAT).

The appellant in this appeal invests in and develops commercial and residential real properties which are leased out to generate income through rents. Following a tax audit for the 2014 – 2016 accounting years, the respondent subjected the appellant to VAT in respect of rental income generated from the appellant’s commercial properties.

The appellant objected to the assessment on grounds that a lease is not a good or service which can be subject to VAT. The appellant argued that a “good” is tangible or moveable personal property other than money, while a “service” is the act of doing something useful for a fee or an intangible commodity in the form of human effort such as labour, skill or advice. The appellant asserted that rental income is neither a good nor a service. Rather rental income is generated from the grant of a license, lease or a form of interest in property as opposed to a transfer of ownership under a supply of goods.

On the other hand, the respondent argued that rent on commercial properties amounts to a supply of goods within the context of the VAT Act because the development of the land into commercial and residential buildings amounts to value added to the land. The respondent relied on the VAT Act (Modification) Order 2018 which expressly excludes from VAT the rent from residential properties, and argued that the silence in respect of rent on commercial properties implies an intention to subject the same to tax.

“According to the TAT, rent on commercial property does not constitute a good or service and therefore is not subject to VAT. The TAT further held that the expression, “the letting out of taxable goods on hire or leasing, and any disposal of taxable goods” contained in section 42 of the VAT Act (now Section 46) “must be construed by reference to goods properly so-called, that is, goods that are moveable or capable of being severed”