Nigeria's Tax Appeal Tribunal (TAT) delivers Landmark Judgment on the Deductibility of Demurrage Payments.

The Tax Appeal Tribunal sitting in Lagos on 28 February 2020, delivered judgement in the consolidated tax appeal filed by Tetra Pak West Africa Ltd (**"Tetra Pak"**/**"The Appellant"**) against the Federal Inland Revenue Service (**"FIRS"** / **"The Respondent"**) where it pronounced on the deductibility of demurrage in Companies Income Tax (**"CIT"**) computations. According to the TAT, demurrage payments incurred by the Appellant were wholly, exclusively, necessarily and reasonably incurred for its business operations. Having met the statutory threshold for tax deductibility, therefore, demurrage charges are deductible in the computation of the Appellant's assessable profits.

Summary of Facts

In 2014, FIRS conducted a tax audit exercise on Tetra Pak in respect of its tax returns for the 2008-2012 years of assessment (**"YOA"**). Upon completion of the audit, FIRS added back several disputed line items to Tetra Pak's Income and on this basis, issued notices of additional assessment for Companies Income Tax and Education Tax (**"EDT"**). One of the added items was the demurrage incurred by Tetra Pak in 2011 and 2012 YOA as a result of clearing delays occassioned by logistical factors outside the control of the Appellant and its partner logistics company.

The FIRS contended that demurrage is, at best, a fine or penalty levied on Tetra Pak and not an expense wholly, exclusively, necessarily and reasonably incurred in accordance with Section 24 of the Companies Income Tax Act (**"CITA"**). FIRS argued that only expenses specifically itemised as deductible in CITA qualiify as tax deductible items. On this basis, FIRS disallowed the deduction of the company's expenditures on demurrage in computing its taxable profit for the 2011 and 2012 YOA.

Tetra Pak disagreed with the FIRS on the deductibility of the expenses incurred on demurrage (among other expenses) and the resulting additional assessment by FIRS. Tetra Pak argued that demurrage was a legitimate business expense which fully satisfied the wholly, reasonably, exclusively and necessarily (WREN) test statutorily prescribed by CITA. CITA. Tetra Pak also challenged FIRS' mischaracterization of demurrage expenses as a penalty which connotes an element of criminality.

The Decision

In the landmark decision, the TAT agreed with Tetra Pak, in ruling that demurrage is not a fine or penalty but a business expense or cost, which is wholly, exclusively, necessarily and reasonably incurred. As a result FIRS was wrong to have disallowed the deduction of the demurrage expense in Tetra Pak's tax returns.

Analysis

There was no dispute between the parties on whether demurrage was incurred. FIRS' grouse was mainly whether the demurrage expense was wholly, exclusively, necessarily and reasonably incurred by Tetra Pak as it was, in its view, an avoidable expense being a fine or penalty. Notwithstanding that there is no provision in the CITA which provides, in particular, that demmurage expenses were not tax deductible, FIRS' arguments appeared to be hinged on the fact that expense would only be deductible if consistent with public policy. Put differently, even though the demurrage payments were necessarily incurred in the course of the Appellant's business operations, FIRS believed that it should be disallowed since it is in the nature of a fine with the intention to punish those who (intentionally or without reasonable care) violate a rule.

Another interesting angle to FIRS' claims is that any expense which is not specifically mentioned in CITA is automatically disallowed. The provision of CITA itself renders such an argument a non-starter. According to section 24 CITA, "*… for the purpose of ascertaining the profits or loss of any company of any period from any source chargeable with tax under this Act, there shall be deducted* ***all expenses for that period*** *by that company wholly, exclusively, necessarily and reasonably incurred in the production of those profits* ***including, but without otherwise expanding the generality of the foregoing…*** ". It is clear from this excerpt that the list of deductible expenses is not exhaustive. It was certainly not the intention of the lawmaker that only the specifically itemised expenses were deductible especially since section 27 of the CITA proceeds to highlight disallowable deductions separately.

While it is laudable that the TAT ruled in favour of Tetra Pak on this controversial issue, it is important to note that this position was supported by the fact that the expenses were unavoidably incurred by Tetra Pak as a commercial expenditure peculiar to its line of business owing to the delays occasioned by circumstances beyond its control, including the poor administrative bottleneck and congestion at the Ports, malfunction of Port facilities and traffic congestion. As a result, the TAT understood the expense is not abnormal in the Appellant's line of business. It is therefore likely that, in a situation different from the present case, the TAT could arrive at a conclusion that the expenses were non-deductible even though it generated income which was subject to tax.

Conclusion

By this decision, the TAT provided the much-needed guidance on the treatment of demurrage as a tax deductible expense which before now was fraught with uncertainities. This has expanded the legal framework for allowable deductions for CIT purposes in Nigeria. It is our belief that a good number of ongoing disputes on demurrage payments will be laid to rest by this decision.

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