AJUMOGOBIA & OKEKE

VODACOM v. FIRS -

Are intangibles goods, services or neither?

Introduction

Nigeria's Value Added Tax Act (the "VAT Act") provides for the imposition of tax on the supply of goods and services. Considering the nature of goods and services, one would have expected that the scope of the VAT Act would not be moot. But the Federal Inland Revenue Service's (the "FIRS") browbeating of taxpayers who trade in intangibles and court decisions on taxation of transactions involving real estate and software have served to introduce uncertainty into the topic. In fact, for some in the business of intangibles, they have structured their commercial arrangements on the conviction that their stock in trade is chargeable to VAT.

The purpose of this newsletter is to explain the purview of the VAT Act by investigating the character of intangibles in order to determine whether they qualify as goods or services, or whether they are neither of them. Of course, if intangibles turn out to be goods or services, then their chargeability to VAT is defensible. But if they are neither, then FIRS has to halt its unlawful VAT collection and harassment of businesses.

Intangibles

An intangible is a thing that is not corporeal. A thing is corporeal if it has a physical and material existence. So, intangibles are invisible in nature.

In this newsletter, a representative number of invisible items will be examined with a view to determining whether they are goods, services, or neither. This list is as follows: services, lease, electricity, bandwidth capacity, mineral title, goodwill, intellectual property, lean gas, franchise and software. Intangibles that exist as rights shall be separated from intangibles that do not exist as rights and each category would be discussed separately.

Intangibles that exist as rights

This class includes lease and mineral title. Also, there are aspects of intellectual property, goodwill and franchise that exist as rights.

Lease

A lease is a contract by which a rightful possessor of real property conveys the right to use and occupy the property to another. The equivalent under Nigerian law is a certificate of occupancy ("C of O") which conveys a right to occupy land. Hence, the descriptions of a C of O as a head lease.

The holder of a C of O can create and transfer occupancy rights over land to others. Any such right to occupy would also qualify as a lease. Consequently, a lease conveys a right to occupy land. In conclusion, a lease transaction involves the supply of a right to occupy land.

Mineral title

Minerals exist in different forms including liquid and gaseous hydrocarbons and mineral ore. Under Nigerian law, ownership of petroleum and minerals generally vests in the government. Persons who desire to work these minerals can be granted the right to do so by the government.

The implication of this is that interest in minerals exists in the form of rights in Nigeria.

Legal nature of a "right"

A right is an interest, claim or ownership that one has in tangible or intangible property. A "right to occupy" therefore consists of interest and claim in relation to the occupation of a property (i.e. land). In a nutshell, a "right to occupy" is an *in rem* proprietary right.

In rem proprietary rights fall within the scope of incorporeal property. A lease or "right to convey" is therefore incorporeal property.

Regarding mineral rights, they attach to land and are therefore part of it. Hence, mineral rights are *in rem* proprietary rights and therefore incorporeal property.

Is incorporeal property liable to VAT?

Incorporeal property refers to *in rem* proprietary rights and legal rights in property that has no physical existence. However, the VAT Act applies only to supply of goods and services. Goods are defined as tangible and movable items while services are an intangible commodity in the form of human effort, skill or labour. Incorporeal property is therefore neither goods nor services. VAT should therefore not apply to incorporeal property.

Intangibles that do not exist as rights

Intangibles that do not exist as rights are services, goodwill, electricity, franchise, intellectual property, software, lean gas and bandwidth capacity.

Services

A service is an intangible commodity in the form of human effort, skill or labour. Basically, it comprises of human exertions. Examples of human exertion include dancing, working, courier and transportation generally, advisory, cooking and consultancy.

However, a distinction should be made between services and the creations or products of services. All man-made items are the products of services. But the products themselves do not constitute services. Examples of products include cars, planes, cooking recipe, novels, computer programme, electricity and extracted petroleum.

So, technical advice would qualify as services as opposed to an item manufactured with the benefit of such advice. A car, manufactured by a combination of effort and skill, would be sold as a car and not as a service. Software, created by dint of industry and skill, would be sold as computer programme and not as service.

Also, a contract to explore an oilfield and obtain geologic data is a contract for services. But, a contract for the acquisition of seismic data is not a contract for services.

Electricity

In 2005, the former state power monopoly, NEPA, transferred a 20 storey building in one of Nigeria's prime real estate locations to the FBIR (now FIRS) in settlement of an alleged VAT liability of N8.6bn (USD24m) on unremitted VAT on sales of electricity. The transaction was facilitated by the assumption of both parties that electricity was either goods or a service.

Electricity is the flow of electrical power or charge. Being a flow, electricity is a thing in motion. Electricity is not tangible and so, would not qualify as goods. Neither is it a service because it is not human exertion but a product in the form of a flow of electrical power.

Software

Software is a program that enables a computer to perform a specific task. It is also data or computer programme and instructions.

Software is distinct from the physical hardware with which a computer is built. It is invisible and therefore not goods. It is also not a service because while a service consists of human exertion in the form of skill, labour and effort, software is a created product in the form of computer data and programmes.

Goodwill

Goodwill is a business' reputation and patronage. It includes customer loyalty, value of a company's brand name, customer base, good customer and employee relations, and any trade name, patent or proprietary technology.

Clearly, goodwill is not a tangible or visible item and so, it is not goods. Neither would it qualify as a service as it does not exist as human exertion. A trade name is a name by which a business has become known in a particular line of business. The patent and proprietary technology aspects of goodwill constitute rights which qualify as incorporeal property, since they are legal rights in property having no physical existence.

Intellectual property

Intellectual property refers to creations of the mind such as inventions, literary and artistic works, symbols, images and names. Intellectual property is divisible into industrial property and copyright. The first includes trademarks, patents, industrial designs and geographical indications while the latter refers to novels, films, plays, drawings, paintings, sculptures, photography and architectural designs. Copyright also includes rights such as the right of performing artists in their performances, producers' of phonograms in their recordings, and broadcasters in their radio and television programmes.

Invention is a patentable item. It is the product of effort and skill. However, it is not effort or skill. Trademark is neither a good nor a service; but a word, phrase, logo or other graphic symbol used to distinguish one product from another. The same can be said for industrial property and novels, films, plays, drawings, painting, sculptures, photography and architectural designs. The rights component of copyright is clearly neither good nor service.

Franchise

Franchise is a license from a franchisor to a franchisee for the latter to use the former's know-how, procedures, intellectual property and business model. A franchise permits a franchisee to use the trademark, trade name, operating system, brand and support of the franchisor.

These items are not goods; neither are they services. Know-how and business model are creations of ingenuity and effort. However, where the transaction includes franchisor support, it may be arguable, especially where the franchisor exerts himself, that this component is a service.

Lean gas

Lean gas is the gas remaining after the heavier hydrocarbon fractions have been extracted from natural gas. Lean gas is also called dry gas or methane. It is usually the specification gas for LNG.

Lean gas is not goods as it has no material or physical existence. It is also not a service, but an item produced from underground reservoirs.

Bandwidth capacity/airtime

Recently, FIRS sealed the offices of some telecoms companies for failure to remit VAT on the sale of their products. One of such companies was Globacom Limited whose headquarters and operational offices were sealed for its failure to remit VAT in the sum of N24.3bn (US67.5m) for its business transactions. Globacom supplies airtime and internet capacity.

Airtime is the amount of time a caller spends talking on a phone. Airtime transactions transfer "talking capacity" to customers enabling them to communicate to the extent of their "talking capacity". It is not goods or services.

Also, in 2016, the offices of Swift Networks Ltd, an internet access provider, were shut down for non-remittance of N702m (USD1.95m). In addition, Vodacom is currently contesting FIRS' assessment of a transaction for the supply of bandwidth capacity in court. Vodacom lost both the tax appeal at the Tax Appeal Tribunal and subsequent appeal at the Federal High Court. The interesting aspect of *Vodacom* v *FIRS* is that the parties are yet to raise and argue the issue of whether bandwidth capacity is goods, service or neither.

Bandwidth is synonym for data transfer rate; it is the amount of data that can be carried from one point to another in a given time. Greater bandwidth indicates greater capacity.

Bandwidth is invisible and so, is not goods. However, it is not human exertion, but data transfer capacity, and so, would not qualify as service.

Any judicial precedent on the taxation of intangible property?

There are two precedents on taxation of intangibles that exist as rights, viz: *FBIR v Ibile Holding* and *CNOOC & SAPETRO v FIRS*.

FBIR v Ibile Holdings

The defendant was in the business of building, selling and leasing properties for commercial purpose.

FBIR assessed its transactions to VAT and it was held by the now defunct VAT Tribunal that the defendant's transactions were taxable because they constituted a "supply of goods".

The basis for this decision was s. 42 VAT Act (now s. 46) which defined "supply of goods" as "any transaction where the whole property in the goods is transferred or where the agreement expressly contemplates that this will happen and in particular includes the sale and delivery of taxable goods or services used outside the business, the letting out of taxable goods on hire or leasing, and any disposal of taxable goods".

"…whole property in the goods is transferred…"

Critique – In view of the definition of "goods", land and buildings cannot qualify as such. Consequently, reference to "goods" in the above quote should not include land and building.

"…letting out of taxable goods on hire or leasing…"

Critique- The subject of letting, hire or lease is taxable goods. However, land and buildings do not qualify as "goods".

CNOOC & SAPETRO v FIRS

SAPETRO was the sole PSC contractor to NNPC in OML 130 PSC. PSC contractor provides the funds for project development and is entitled to production as compensation. SAPETRO assigned 90% of its PSC contractor's interest to CNOOC. FIRS attempted to collect VAT from the transaction.

CNOOC filed a suit at the Federal High Court (the "FHC") challenging FIRS' decision. The FHC agreed with CNOOC that the transaction was not liable to VAT because PSC contractor's interest was neither a good nor service. The FHC held that PSC contractor's interest consists of rights and therefore constituted incorporeal property.

The FHC noted that in England, incorporeal property is liable to tax because it was expressly included as a taxable item by s. 5 (2) (b) of the UK VAT Act 1994 which provides as follows:

> "Anything which is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right) is a supply of services".

To the extent that no such statutory reference to rights is contained in Nigeria's VAT Act, the supply of incorporeal property is not taxable.

Vodacom v FIRS

Vodacom v FIRS does not constitute a precedent. This is because the nature of bandwidth capacity was not argued or adjudicated therein.

Which is the better precedent?

CNOOC & SAPETRO v FIRS is the better precedent.

In *CNOOC & SAPETRO v FIRS*, the FHC defined the legal nature of the right involved in PSC contractor's interest as incorporeal property which issue would be crucial in any tax litigation involving any intangible that exist as rights. By contrast, in *FBIR v Ibile Holdings*, the VAT Tribunal did not attempt to define the legal right involved in the transaction. Consequently, it did not address the issue of whether the VAT Act extends to incorporeal property, which was a necessary issue.

In *CNOOC & SAPETRO v FIRS*, the FHC attempted the definition of the chargeable items for VAT, i.e. "goods" and "services". On its part, the VAT Tribunal failed to define these chargeable items. Rather, it sought to define "supply of goods" which was not necessary.

The definition of "supply of goods" was not necessary because of the following:

(i) Once an item is a good, its supply becomes liable to VAT automatically, unless the good is exempted from VAT. So, definition of "goods" alone would suffice.

(ii) Also, the definition of "supply of goods"makes reference to "goods". Consequently, "goods" still has to be defined for any definition of "supply of goods" to be meaningful.

In addition, the VAT Tribunal's decision is indefensible for equating land and buildings to "goods". "Goods" are movable. Neither land nor building is movable.

Conclusion

The scope of VAT is strictly limited to goods and services. It does not extend to any other item. Services, being invisible in nature, have tended to create the impression that all intangibles are taxable. This newsletter highlights the point that services although intangible, do not belong to the categorization – intangible property.

Intangible property either exists as rights or otherwise. Intangible property that exist as rights belong to a class of property known as incorporeal property which Nigerian case law regards as not liable to VAT. The other type of intangible property differs from services due to the fact that it consists of creations and products of services. Being creations and products, it falls outside the definition of services. Taxing any supply of intangible property is therefore contrary to the VAT Act and should be discontinued.

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