ÆLEX

TAX SUBSTITUTION: WHAT THE LAW SAYS AS FIRS SEEKS TO RECOVER TAXES THROUGH COMMERCIAL BANKS

DR. JEROME OKORO

Jerome is a Senior Associate and a member of the firm's Taxation and Dispute Resolution Practice Groups

jokoro@aelex.com

INTRODUCTION

Following its earlier expression of interest to go after alleged tax defaulters with huge funds in Nigerian banks, the Federal Inland Revenue Service (FIRS) recently issued letters to commercial banks, appointing them as tax collection agents for their customers.[1] The letters directed the banks to freeze certain named accounts in order to facilitate tax recovery. This mode of tax recovery through third parties (known as 'tax substitution)'[2] particularly with the account-freezing dimension that the FIRS introduced, has raised diverse reactions from various commentators.

Some view the measure as a laudable scheme with good prospects of raising substantial revenue for government and blocking tax leakages. Others have aired reservations on the appropriateness of FIRS' approach when considered in the light of relevant legislation, and the far-reaching economic implications it may have investment climate in Nigeria.[3] This article identifies and responds to the legal controversies of tax enforcement through tax substitution with a highlight on the appointment of commercial banks as taxpayers' agents of the FIRS.

POWER OF THE TAX MAN TO APPOINT AN AGENT FOR A TAXABLE PERSON

Before the enactment of the Federal Inland Revenue Service (Establishment) Act, 2007 ("FIRS Act"), Section 49 of the Companies Income Tax Act ("CITA"), 1990 and Section 50 of the Personal Income Tax Act ("PITA"), 1993 provided for tax substitution by the tax authorities.[4] Section 31 of FIRS Act reproduced these respective provisions as follows:

---

[1] Anxiety as FIRS Moves to 'manage' Defaulting Taxpayers' Bank Accounts. *Businessday* August 27, 2018. https://www.businessdayonline.com/exclusives/article/anxiety-firs-moves-manage-defaulting-taxpayers-bank-accounts/. Accessed on 1 November 2018.

[2] The term substitution is used in the marginal note to Section 31 of the Federal Inland Revenue Service (Establishment) Act which provides for this process.

[3] LCCI kicks against freezing tax defaulters' accounts. *The Nation* August 20, 2018.

http://thenationonlineng.net/lcci-kicks-against-freezing-tax-defaulters-accounts/. Accessed on 1 November 2018.

[4] Before the enactment of the FIRS Act 2007 which established FIRS, the Companies Income Tax Act No. 22 of 1961 established the Federal Board of Inland Revenue

"(1) The Service may by notice in writing appoint any person to be the agent of a taxable person if the circumstances provided in sub-section (2) of this section makes it expedient to do so.

(2) The agent appointed under subsection (1) of this section may be required to pay any tax payable by the taxable person from any money which may be held by the agent of the taxable person."

From the above provision, the appointment of an agent is discretionary and it depends on the consideration of the tax authority that such appointment has become expedient. However, the actual recovery of tax through an appointed agent is subject to 2 conditions, namely:

(a) That money is held by the agent; and

(b) That tax has become payable by the taxable person.

WHEN IS TAX PAYABLE?

The second condition in Section 31(2) of the FIRS Act embodies the knotty issues of tax substitution. It raises the cardinal question: when does tax become payable by a taxable person to warrant tax recovery through a FIRS-appointed agent of the taxable person?

Generally, the process of income tax payment commences with tax assessment – computing the tax liability of a taxable person. Section 65(1) of the Companies Income Tax Act[5] ("CITA") enables FIRS to raise an assessment on a company when the time allowed for the company's submission of its audited accounts and returns has expired. Section 54(1) of the Personal Income Tax Act[6] ("PITA") which applies to individuals and other unincorporated entities, makes a similar provision.

There are two broad types of tax assessments namely: assessment based on a taxpayer's returns and 'Best of Judgment' assessment. The former is computed using information

[5] Cap C21, Laws of the Federation of Nigeria, 2004 (as amended in 2007).
[6] Cap P8, Laws of the Federation of Nigeria, 2004 (as amended in 2011).

from the tax payer's returns and audited financial statement which can be verified by the tax authority. With the introduction of 2011 Tax Administration (Self-Assessment) Regulations, self-assessment provisions in existing tax legislation such as Sections 52(2) and 53 of CITA and Section 44 of PITA came to life and taxpayers have increasingly embraced the self-assessment mode. The self-assessment regime offers taxpayers a voluntary compliance opportunity whereby they compute and pay their taxes, and then file self-assessment returns with evidence of the payment.

The essence of formal assessment is to confirm the accuracy of the payment. Where the taxable person fails to comply with self-assessment requirements, the self-assessment tax provisions require the tax authority to raise an administrative assessment prior to tax recovery. This indicates that in the absence of voluntary compliance, tax assessment and the opportunity of objection are indispensable.

Sections 65(2)(b) and 65(3) of CITA; and sections 54(2)(b) and 54(3) of PITA have similar provisions on 'Best of Judgment' Assessment. In both legislation, the circumstances warranting a Best-of-Judgment assessment are that: (a) The tax authority refused to accept the audited financial statement and returns filed by the taxable person; and (b) the taxable person has not submitted returns within the prescribed period or might not even have been in the tax net (i.e. has not registered and obtained Taxpayer's Identification Number) but the authority has cause to believe that the person is liable to tax.[7] Best of Judgment assessment also buttresses the tax law position that with or without returns or financial statements from a taxable person, FIRS must first issue an assessment and let the objection and appeal periods run out before any attempt at enforcing payment.

Service of an assessment on the taxpayer is followed by the taxpayer's objection in writing to the tax authority stating its grounds of fact and law for the objection. The tax

[7] See also Paragraph 3.0 of ***FIRS Information Circular No. 2005/03*** on Preparation and Processing of Best of Judgment Assessment, released in February, 2006. The mode of a Best of Judgment assessment is discretionary, but in ***Nigerian Breweries Plc. v Lagos State Internal Revenue Board (2001) FWLR (Pt. 72) 1972***, the Court of Appeal held that the revenue officer making the assessment should not be dishonest, vindictive; or capricious.

authority in turn considers the objection and also exercises one of three options namely: amending the assessment; discharging it outright or maintaining its position on the assessment. If it chooses the last of the three, it would issue a Notice of Refusal to Amend the Assessment (NORA). The assessment is said to be final and conclusive if at the expiration of the period stipulated by law for objection, the taxpayer fails to object to the assessment; or having objected and received a NORA, fails to further challenge the assessment in court within the stipulated period after the NORA as provided by Paragraph 13(3) of the 5th Schedule to the FIRS Act.

A disputed tax assessment that is under litigation becomes final and conclusive when the court upholds it in a judgment, subject to the taxpayer's right to appeal against the judgment within the stipulated time. Thus, the assessment is not final and conclusive until all appeals, up to the Supreme Court are exhausted. Paragraph 16(3) of the 5th Schedule to the FIRS Act however, provides that despite the pendency of an appeal against a decision of the Tax Appeal Tribunal, tax shall be paid in accordance with that decision within one month of notification of the amount of tax payable. This is obviously meant to ensure that the FIRS does not lose the time value of tax money to litigation considering that tax refund under Section 23 of the FIRS Act would avail the taxpayer who succeeds in an appeal after paying the disputed tax.

There have been judicial restatements of the prerequisites for tax enforcement in several cases. In ***Federal Inland Revenue Service v. Gazetta Communications Limited***[8], FIRS assessed the Defendant to various taxes following an audit exercise, which the Defendant failed to pay or file an objection to the taxes within 30 days of the assessment. The FIRS consequently brought an action at the Federal High Court seeking a summary judgment for the payment of the assessed amounts under the undefended list procedure.

[8] (2013) 10 TLRN 1.

The court held that the Defendant's failure to react to the assessment as and when stipulated by law made the assessment final and conclusive, hence the tax became recoverable by FIRS. Also in ***Medos v. Commissioner for South African Revenue Service***[9], the Supreme Court of South Africa voiced the consensus that "where no objection is made to an assessment issued by the relevant tax authority, the assessment is final and conclusive as between the tax authority and the taxpayer."

When an assessment becomes final and conclusive, the tax therein becomes payable. In other words, the tax is payable immediately after the expiration of the period for objection or appeal as the case may be, or after exhaustion of all appellate opportunities.

THE ASSESSMENT-OBJECTION PROCESS IN TAX SUBSTITUTION

It may be argued that the provisions of Section 31(1) and (2) of FIRS Act are to the effect that the assessment and objection periods be first exhausted, and the tax payable before FIRS can appoint an agent for the taxpayer.

This argument may be untenable because, as noted earlier, tax becoming payable under Section 31(2) is a condition for the recovery of the tax from the FIRS-appointed agent, and not a condition for appointing the agent *ab initio*. The agent is appointed based on FIRS' discretion upon deeming it expedient to recover tax from the taxpayer's money in the agent's hands. But after the appointment, the actual recovery of tax is subject to the tax becoming payable. In this regard, Section 31 (5) of the FIRS Act implies that notification of the appointment of the tax agent doubles as a notice of assessment. The section provides:

> *"The provisions of this Act with respect to objections and appeals shall apply to any notice given under this section as if such notice were an assessment."*

[9] (2016) 21 TLRN 73.

The above provision means that in tax substitution (i.e. tax recovery from FIRS-appointed agents), the notice appointing the agent serves as a notice of assessment. Thus, the assessment-objection process starts with the notice of appointment of the agent.

The first issue on the appointment notice is whether it ought to be served directly on that taxable person whose liability is alleged considering that it is deemed an assessment notice by virtue of Section 31(5) of the FIRS Act or whether service on only the appointed agent would suffice. Section 68 of CITA, with material similarity to Section 57 of PITA provides:

> "The Board shall cause to be served on or sent by registered post to ***each company, or person in whose name a company is chargeable***, whose name appears on the assessment lists, a notice stating the amount of the total profits, the tax payable, the place at which such payment should be made, and setting out the rights of the company under the next following section." (*Emphasis added*)

The highlighted part in the above provision indicates alternative service of the appointment cum assessment notice on the taxpayer or his appointed agent. In other words, FIRS' choice to serve it on the agent could suffice and dispense with the need for further service on the taxable person.

Nonetheless, service on only the appointed agent (the banks in recent cases) offends the constitutional right fair hearing as enshrined in Section 36(1) of the 1999 Constitution which provides that a person against whom a decision would be taken must be given a prior opportunity of a representation. This constitutional angle is further addressed in details below.

The above provision on assessment also requires that the notice of appointment, being an assessment, must state the total profits, the tax payable and the right of objection to the assessment.

FIRS' POWER OF FUND FREEZING, CONFISCATION OR SEIZURE

Section 44 of the 1999 Constitution which creates a general ground for the freezing of bank accounts, equally provides strict safeguards in the exercise of that power. It states:

> *"No moveable property or any interest in an immovable property shall be taken possession of compulsorily and no right over or interest in any such property shall be acquired compulsorily in any part of Nigeria except in the manner and for the purposes prescribed by a law that, among other things –*
> *"(a) requires the prompt payment of compensation therefore and*
> *(b) gives to any person claiming such compensation a right of access for the determination of his interest in the property and the amount of compensation to a court of law or tribunal or body having jurisdiction in that part of Nigeria."*

Subsection (2) of Section 44 provides:

> "*Nothing in subsection (1) of this section shall be construed as affecting any general law (a) for the imposition or enforcement of any tax, rate or duty.*"

Money in a bank account is in the category of movable property referred to in Section 44 above. The section requires that the freezing of an account must conform to an enabling law. A pertinent question here is: which tax law enables the FIRS to freeze accounts?

By virtue of the provisions of Section 8(1)(g) of the FIRS Act, the FIRS can, "*adopt measures to identify, trace, freeze, confiscate or seize proceeds derived from tax fraud or evasion.*" This section seemingly veils the FIRS with a carte blanche prerogative as it lacks necessary safeguards from abuse.

In comparison, Section 34(1) of the Economic and Financial Crimes Commissions (EFCC) Act which enables EFCC to freeze bank accounts pursuant to its investigative

duties provides a shield from abuse. The provision mandates EFCC to first obtain an *ex parte* order of court prior to the freezing of an account.[10]

It is however clear that Section 8(1)(g) of the FIRS Act does not relate to tax substitution under Section 31 of the Act. From the wording of Section 8(1)(g), FIRS' power to freeze accounts relates only to "*proceeds derived from tax fraud or evasion.*" Tax fraud or evasion are crimes specifically embodied in the law which must be established by judicial procedure, and not administratively by an executive authority.

Section 34(1) of the EFCC Act enables EFCC to freeze an account with an *ex parte* order of court upon mere suspicion by EFCC that the funds relate to a financial crime. Section 8(1)(g) of the FIRS Act, on the other hand, makes the issue of tax fraud and tax evasion conclusive. In other words, either or both of the two crimes must have been established before that section can be invoked to freeze an account or confiscate funds.

Where a tax liability has not been subjected to the challenge process which might bring it under dispute, the issue of tax fraud or evasion is inexistent. It is also beyond contest that a person cannot be held culpable of tax fraud or evasion where the right to challenge an allegation of tax liability against him is still open. This means that Section 8(1)(g) of the FIRS Act does not justify FIRS' directive to the banks to freeze their customers' accounts for the purpose of tax substitution.

THE CONSTITUTIONAL ANGLE

The opening provision on fair hearing in Section 36(1) of the Constitution grants fair hearing to a person coming before a court or other legally established tribunal. Subsection (2) enables government bodies to determine legal questions affecting the civil rights and obligations of a person with a strict condition that the person be given an opportunity to make representations before any decision affecting him can be reached.

---

[10] On the basis of this law, the court has consistently faulted restrictions on bank accounts without prior court order. See ***Chidolue v EFCC (2012) 5 NWLR (PT 1292).*** This relates to the established principle that the non-fulfilment of a prescribed condition precedent before doing an act renders the act null and void. See ***Aina V Jinadu (1992)4 NWLR (PT 233)91.***

A notice from FIRS appointing an agent for a taxable person, when viewed as an assessment notice under Section 31(5) of the FIRS Act, is a mere allegation, and not a verdict of tax liability against the taxable person. The notice is therefore subject to the constitutional rule of fair hearing which entails that it must clearly state the alleged liability and be served directly on the taxable person to afford the person an opportunity to object. To take any further step on the notice, like account freezing, before the opportunities of objection and appeal are exhausted, is against the constitutional demands of fair hearing.

CONCLUSION: NAVIGATING THE LAWS CAREFULLY

Enforcement of the relevant laws on tax recovery as analysed above requires adherence to constitutional standards of fair hearing. The way to meet the standards is by creating an avenue for a taxable person to challenge a tax assessment raised against him prior to tax enforcement by the relevant authority. In order to comply with the constitutional provisions of fair hearing, Section 31(5) of the FIRS Act considers the notice of appointment of an agent as an assessment notice, and mandates that other provisions of the law concerning assessments, objections and appeals be observed in respect of the appointment notice.

It therefore, behoves FIRS to clearly state the tax liabilities in the appointment notices; indicate in the notices the right of objection; serve the notices directly on the taxable persons and not just on their FIRS-appointed agents; and allow the periods provided in the various laws for objection and appeal to run out before making any move for tax enforcement.

Toeing a different route would amount to offending Section 36(1) of the constitution and Section 31(5) of the FIRS Act. It bears repeating that Section 31 of FIRS Act does not envisage the freezing of a taxable person's bank account since it does not suggest any circumstance of tax fraud or evasion which are the basis for the freezing of funds or

confiscation in Section 8(1)(g) of the FIRS Act. Thus Section 8(1)(g) offers no statutory justification for the freezing of the bank accounts of taxable persons.

ÆLEX is a full-service commercial and dispute resolution firm. It is one of the largest law firms in West Africa with offices in Lagos, Port Harcourt and Abuja in Nigeria and Accra, Ghana.

Contact us at:
4th Floor, Marble House,
1 Kingsway Road, Falomo Ikoyi,
Lagos, Nigeria
Telephone: (+234-1) 4617321-3, 2793367-8, 7406533, E-mail: lagos@aelex.com
To see our other office locations, please click HERE www.aelex.com

You may also visit our social media pages: