



Information Circular 02/2007
Notification of Guidelines on the Implementation of VAT
Deduction (Reverse Charge) and New Payment Arrangement
with Respect to Fees, Levies, and other Charges Payable by
Companies in Oil and Gas Industry

1.0 Introduction

This notice is to provide guidelines to the companies operating in Oil and Gas Industry on the method of implementation of the provision of Section 10A(2) of the Value Added Tax Act as amended by the VAT (Amendment) Act, 2007 which dealt with deduction of VAT at source.

The notice is also to brief the companies on the action taken so far in the implementation of Section 2, 25, 68 and Schedule 1 of the recently promulgated Federal Inland Revenue Service (Establishment) Act, 2007 concerning new method of payment of signature bonuses, royalties, pipeline fees, penalties for gas flared, fees for Oil Prospecting License (OPL), Oil Mining Licence (OML), rents etc etc.

The two provisions of the laws will be treated separately as follows:-

2.0 VAT Deductions by Companies in the Oil and Gas Sector

2.1 Legal Provisions

The VAT Act has introduced a new Section 10A(2) which imposes some responsibility on companies in the oil and gas industry to act as agent of VAT collection as part of the strategy towards ensuring

optimum tax collection from the sector. The section stated as follows:

“The Service may, by notice, determine and direct the companies operating in the oil and gas sector which shall deduct VAT at source and remit same to the Service”

This new tax provision is in every way, similar to the provisions of Sections 9 and 10 of the VAT Act, 2004 which require Government Ministries, Departments and Agencies (MDAs) that have contract agreements with contractors and companies in Nigeria which have contract agreement with non-resident companies, to hold back VAT charges due on contracts awarded by them and remit such deductions directly to FIRS.

In carrying out this responsibility, there is the need to distinguish between taxable activities conducted by a company in course of its normal business and its consumption of goods and services, which requires it to act as a VAT agent under this new provision. In the first case, it could charge VAT from customers with respect to its sales transactions, while on the other hand it is also required to withhold VAT chargeable on its own consumption of goods and services (Reverse Charge). The exercise of this latter responsibility is ABSOLUTE and does not permit any input adjustment from the output VAT based on normal business activities.

The companies and other parties connected with the implementation of this provision have the following duties and obligations:

2.2 **Duties and Obligations of Companies Awarding Contracts in the Sector**

The duties and obligations of companies in oil and gas sector include the following:

- i) Withholding and remitting to FIRS, the VAT charges due on all contract awards to their contractors;
- ii) Prepare and forward to FIRS, relevant schedules on all VAT payments indicating name and address of each contractor, tax identification number (TIN), invoice number, contract value, dates of contract award and payment as well as VAT amount;
- iii) Demand from FIRS, relevant receipts covering all its VAT payments;
- iv) Separate the returns on normal trading activities from those of its own consumption/contract awards. The input and output credit mechanism will apply only to its sales activities, but not to contract awards;
- v) Recognize that they have a duty to pay VAT on all the contracts being awarded, (with the exception of those for exempted goods and services), whether or not their Contractors have duly reflected VAT charges on such contracts.
- vi) Provide evidence of VAT withheld to the contractors which would show the following:
 - a) The total contract sum;

- b) The amount of VAT deducted at source
- c) The date of payment of tax to FIRS; and
- d) The office of the FIRS which has received value for the payment.

One of the reasons for providing evidence of VAT withheld to the contractors is to facilitate the claim of refund, if any, from the FIRS by the contractors.

2.3 **Duties and Obligations of Contractors**

Contractors providing services to companies in the Oil and Gas sector have some obligations under the VAT Act and will be required to note the following:

- i) Quote relevant Tax Identification Number (TINs) on all contract invoices submitted by them to their contract employers;
- ii) Provide and reflect VAT charges on all invoices issued to the contract employers;
- iii) Recognize that the VAT Act limits input taxes that are allowable to only input taxes paid on goods meant for resale or on raw materials intended for the production of goods for sale. Other input taxes should be treated along with relevant costs in the Profit & Loss account; and
- iv) File monthly VAT returns to FIRS indicating name and address of each contractee, tax identification number (TIN),

invoice number, contract value, dates of contract award and payment as well as VAT amount.

2.4 **Duties and Obligations of FIRS**

The FIRS has responsibility for the following:

- (i) Prompt issuance of receipts for payments made by Taxable persons;
- (ii) Prompt confirmation of payment made by companies to FIRS (if demanded by the contractor)
- (iii) Prompt processing of refunds for claims made by contractors and others as may be required by law in the processing of refunds to taxpayers; and
- (iv) Provide assistance to companies and contractors in the smooth implementation of the law.

2.5 **Coverage of the New VAT Provision**

The new directive will extend to all companies providing services in the Oil and Gas sector, including upstream and downstream operations as well as the oil servicing companies. In the same vein, VAT liability will cover all goods and services with the exception of contracts for the supply of VAT-exempt items and those described in paragraph 2.5.1 below:

2.5.1 **Exceptions to the VAT Regulation**

The new directive will not apply in the circumstances described here-under:

- i) Where the party supplying the good or service is a Government Agent such as Water Board, PHCN, etc the company will not deduct VAT at source since all Government Agencies are also empowered by law to deduct VAT a source under Section 10 A(1) of the VAT Act unless otherwise directed.
- ii) Where goods are purchased off the shelf i.e without contract between the parties, the provision of Section 10A(2) of the Act will not apply. Off the shelf purchases include, for example, purchase of air tickets at the office of an airline by an officers of a company, purchase of stationery and other writing materials at a shop, provision of hotel services on cash basis, purchase of recharge card at open markets etc etc. The provision of the law will however apply to cases where contracts are signed between the parties for such services. For example, utility services such as provision of hotel or catering services, telephone services, air travel, etc which are based on contractual agreements will be subjected to VAT deduction at source. It is therefore important, in signing contract of supply, that the attention of the supplier is drawn to the provision of the VAT Act as it relates to tax deduction at source.

- iii) Invoices for goods and services exempted from VAT as provided in the VAT Act will not be subject to VAT deduction.

2.6 **Claim of Input VAT Arising from VAT Deducted at Source**

Where, as a result of VAT deducted at source by an Oil and Gas company, the overall input VAT of a contractor exceeds its overall output VAT, the contractor shall be entitled to refund from FIRS on the excess as stipulated by Section 16 of the VAT Act.

The FIRS shall refund in accordance with Section 23 of the FIRS (Establishment) Act, 2007 and the established procedure subject to the provisions of Section 17 of the VAT Act.

2.7 **Definition of Allowable Input Taxes**

Without prejudice to the provisions of the input-output VAT mechanism under Section 16 of the VAT Act, it is important to explain that only input taxes attributable to manufacturing or sales activities are qualified as allowable for the purpose of input/output adjustment.

- i) Section 17(1) of the VAT Act clearly provides that the input tax to be allowed as a deduction from output tax shall be limited to “the tax on goods purchased or imported directly for resale and goods which form the stock-in-trade used for the direct production of any new product on which the output tax is charged”

- ii) The Act further allows companies which have suffered input taxes on overhead, service and general administration of their businesses to expense such VAT charges along with relevant costs in the company's Profit and Loss account as well as capitalize all input VAT charges on any capital item in the Assets accounts of the company
- iii) Note that input taxes in relation to contracts of services are not allowable as deduction against output VAT. The relevant VAT provisions have specifically indicated how such input taxes should be treated along with relevant costs in the Profit and Loss account.

With the above explanation, it would be apparent that, except where a contractors or company in the oil and gas sector engages in supply or use of construction materials, manufacturing or trading activity, e.g manufacturing or purchase of tools or fabrication of equipment for sale, it cannot qualify to claim any input taxes.

2.8 **Commencement Date of the New VAT Deduction**

For the purpose of taxpayers' convenience and bearing in mind that FIRS has been in constant dialogue with representatives of Operators in the Oil and Gas sector, the commencement date of implementation of the law is not later than 1st September, 2007.

3.0 **Proposed Arrangement for the Collection of Fees, Levies and Other Charges Associated with Petroleum Operation**

The FIRS (Establishment) Act, 2007 has in Section 2, 25 and 68 provided FIRS with powers to control and administer all Revenue laws specified in the First Schedule to the Act, particularly those referred to in paragraph 11 of the Schedule, which include, taxes, fees, levies, royalties, rents, signature bonuses, penalties for gas flaring, depot fees, licences, fees for Oil Mining Licence (OML), Oil Prospecting Licence (OPL), etc. There is already on-going discussion between Federal Inland Revenue Service (FIRS), Office of the Accountant General of the Federation and other Stakeholders to ensure the smooth implementation of the regulation and transition from the current regime to the new one in a short while. In the meantime, Oil and Gas companies are requested to continue making payments on the basis of the existing regime, while bearing in mind that in due course, notification would be made to them with regard to when the new payment system would commence.

4.0 Should there be any further inquiries or comments on this Notice, such inquiries or comments are advised to be addressed to any of the five (5) offices listed below:

*Office of the Executive Chairman,
Federal Inland Revenue Service,
Revenue Service,
Plot 522, Sokode Crescent,
Wuse Zone 5,
Abuja
Tel: 09-6701467*

*Office of the Coordinating Director,
Tax Operation Group,
Federal Inland Revenue Service,
Revenue House,
Plot 522, Sokode Crescent,
Wuse Zone 5,. Abuja.
Tel: 09-5236610
Fax: 09-5236601*

*Office of the Director, Tax Policy Dept.,
Federal Inland Revenue Service,
Revenue House,
Plot 522, Sokode Crescent
Wuse Zone 5,
Abuja
Tel:*

*Office of the Ag Head/Oil & Gas,
Federal Inland Revenue Service,
UBA House, 7th Floor,
57 Marina, Lagos
Tel: 01-2644034
Fax: 01-2666856*

*Office of the Tax Controller,
Large Tax Office,
Federal Inland Revenue Service,
74 Stadium Road,
Por Harcourt.
Tel: 084-774668
084-785841*

Under the Authority of the Executive Chairman, FIRS

It pays to pay tax on time!