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TAX APPEAL TRIBUNAL RULES ON THE SCOPE OF "STOCK-IN-TRADE" FOR THE PURPOSE OF DEDUCTIBLE INPUT VAT

Background

By virtue of section 16 of the Value Added Tax Act (as amended) (the "**VAT Act**"), a taxable person, while filing monthly Value Added Tax ("**VAT**") returns with the Federal Inland Revenue Service ("**FIRS**"), is:

- Required to remit excess tax to the FIRS, if the output tax collected exceeds the input tax paid; and
- Entitled to utilize any excess tax as a credit against subsequent months, if the input tax paid exceeds the output tax collected. Where any excess tax is not utilized as a credit, it will be refunded to the taxpayer if the claim is backed by adequate documentation; as the FIRS may require.

Section 17(1) of the VAT Act sets the limits of the input tax to be allowed as a deduction from output tax. In essence, the allowable input VAT deductions are limited to instances where VAT is incurred on:

(i) Goods purchased or imported directly for resale; and
(ii) Goods which form the stock-in-trade used for the direct production of any new product, on which the output tax is charged.

The phrase, "stock-in-trade", is not defined in the VAT Act. The question of what constitutes "stock-in-trade", for the purpose of deductible input tax under section 17(1) of the VAT Act, has therefore been a burning issue. This question was answered by the Tax Appeal Tribunal, Lagos Zone ("**TAT**"), in the recent case of **Chi Limited v FIRS (Unreported judgment delivered on February 10, 2022, in Appeal No. TAT/LZ/VAT/006/2021)** ("**Chi v FIRS**").

Facts and decision in the case

In **Chi v FIRS**, the appellant, a company engaged in the business of production of fruit juice, dairy, and other products in the beverage and snack categories, requested from the FIRS, an advance tax ruling permitting the appellant to recover input VAT incurred on the purchase of gas, short-term spares, and consumables against the VAT it charged on its products (Output

VAT). The request was to determine whether the input VAT qualified as the appellant's stock-in-trade, for the purpose of the deduction allowed under section 17(1) of the VAT Act.

The FIRS refused to grant the appellant's request, on the ground that the appellant produces fruit juices, dairy, and other products. The FIRS contended that natural gas and diesel, short-term spares, and other manufacturing consumables are not the appellant's stock-in-trade or raw materials in the production of its products. According to the tax authority, these items form part of the company's production overhead (as attested to in the company's request letter) and as such, they are not deductible against the output tax arising from the sale of the company's products.

Dissatisfied, the appellant challenged the FIRS' ruling by filing an appeal before the TAT, on the grounds that the FIRS' interpretation of section 17(1) of the VAT Act was wrong. The appellant contended that its inventory or production overheads (such as the natural gas, short-term spares, and manufacturing consumables) form part of its stock-in-trade and input VAT on them are therefore deductible from output VAT, upon a holistic interpretation of the provisions of sections 16, 17(1) and 17(2) of the VAT Act.

In the absence of a definition in the VAT Act, the TAT, in determining the appeal, had recourse to the definition of "stock-in-trade" in the Black's Law Dictionary, as follows:

(i) The inventory carried by a retail business for sale in the ordinary course of business;
(ii) The tools and equipment owned and used by a person engaged in a trade; and
(iii) The equipment and other items needed to run a business.

Relying on this definition, the TAT agreed with the appellant and held that stock-in-trade ordinarily means resources or assets used to operate a business and therefore goes beyond raw materials contrary to FIRS' contention.

Further, the TAT inquired into the question of whether a direct link exists between the appellant's stock-in-trade (gas, spares, and manufacturing consumables) and the production of any new product by the appellant, for the purpose of determining the appellant's eligibility to recover all input VAT incurred thereon. The question was also resolved in favour of the appellant.

The TAT accordingly made an order, directing the FIRS to allow the appellant to claim deduction on the input VAT incurred on natural gas, short-term spares, and other consumables used in the direct production of its final products.

Commentary

As noted by the TAT in the case, the underlying principle of VAT in sections 16 and 17 of the VAT Act, is for manufacturers to recover all input VAT, as much as possible. It is also for the ultimate VAT burden to be borne by the final consumer of the manufacturer's products. Against this backdrop, the TAT was right, in our view, to have aligned with the appellant's contention; that the provisions of section 17 of the VAT are deliberately elaborate, because the legislature intends that the input VAT to be recovered by manufacturers should not only relate to raw materials but to all inventory, overheads, tools and equipment used directly in production by a manufacturer and which have a direct link/ connection with the manufacturer's products.

Overall, the TAT decision in **Chi v FIRS** is a welcome development and heralds a new dispensation for manufacturers' ability to claim input tax deduction on all resources and assets used to operate their business – which have a direct link with the production of their products.

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