

# UNDERSTANDING TAXATION OF CHARTER PARTY CONTRACTS IN NIGERIA'S MARITIME INDUSTRY

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## 1. INTRODUCTION

The world over, every country has its own set of rules governing its coastal trade. Players in this sector either own the ships which are leased to charterers or lease vessels from vessel owners for the purpose of further leasing same to charterers who make use of the vessels to transport their goods and services. Transactions in this sector are usually guided by the country's applicable coastal laws. However, when a vessel is provided on charter to a player in the oil and gas industry, such a transaction is not only guided by the country's applicable coastal law, it is also guided by relevant oil and gas law. Transactions entered into this regard also have their tax implications.

This article intends to explore the types of taxes applicable to a maritime services company providing charter party services in the Nigerian maritime sector.

## 2. WHAT ARE CHARTER PARTY CONTRACTS?

A charter party is a document which sets out in writing the terms of a charter agreement between a ship owner and a charterer.

Under this contract, the owner of the vessel lets out (hires) the vessel to a third party (known as the charterer) for the purpose of transporting passengers or cargo either for a fixed time (time charter) or for the duration of a voyage (voyage charter). The transportation of goods and passengers by a vessel from one port to another port within a country is referred to as coastal trade or cabotage.<sup>2</sup> In Nigeria, the Nigerian Coastal and Inland Shipping (Cabotage) Act, 2003 defines the term 'Coastal Trade' or 'cabotage' as:

*"(a) The carriage of goods by vessel, or any other mode of transport, from one place in Nigeria or above Nigeria waters to any other place in Nigeria or above Nigeria waters, either directly or via a place outside Nigeria and includes the carriage of goods in relation to the exploration, exploitation or transportation of the mineral or non-living natural resources of Nigeria whether in or under Nigerian waters;*

*(b) The carriage of passengers by vessel from any place in Nigeria situated on lake of river to the same place, or to any other place in*

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<sup>2</sup> Coastal Trading Definition. Obtained from [www.duhaime.org/LegalDictionary/C/CoastalTrading.aspx](http://www.duhaime.org/LegalDictionary/C/CoastalTrading.aspx) and accessed on 23 January 2019



Nigeria, either directly or a place outside Nigeria to the same place without any call at any port outside Nigeria or to any other place in Nigeria, other than as an in-transit or emergency call, either directly or via a place outside Nigeria;

(c) The carriage of passengers by vessel from any place in Nigeria to any place above or under Nigerian waters to any place in Nigeria, or from any place above Nigerian waters to the same place or to any other place above or under Nigerian waters where the carriage of the passengers is in relation to the exploration, exploitation or transportation of the mineral or non-living natural resources in or under Nigerian waters; and

(d) The engaging, by vessel, in any other marine transportation activity of a commercial nature in Nigerian waters and, the carriage of any goods or substances whether or not of commercial value within the waters of Nigeria”

### 3. TAXATION OF CHARTER PARTY CONTRACTS IN NIGERIA

In Nigeria, a typical charter transaction is subject to the following tax liabilities:

- (a) Withholding tax;
- (b) Nigerian Content Development Levy (where the counter party is a player in the oil and gas industry);
- (c) Cabotage Surcharge; and
- (d) Value Added Tax.

These taxes shall be discussed below under their various headings:

### **Withholding Tax**

Withholding Tax is an advance payment of income tax. In principle, WHT is a payment on account of the ultimate income tax liability of the taxpayer or company. They can only be applied as tax credit to settle the assessment of the year to which the income that suffered deduction relates.<sup>3</sup> Withholding tax is not a separate tax on its own and does not confer an exemption from the filing of annual tax returns by the company which had suffered WHT. The tax is normally to be deducted at source when a payment is to be made to the beneficiary.<sup>4</sup>

The WHT provision was introduced into the tax system in 1977 and initially limited to rent, dividend and directors’ fees. It has however, pursuant to the Regulations made in accordance with section 81 of the Companies Income Tax Act (CITA) been expanded to include:<sup>5</sup>

*“(a) all aspect of building, construction and related services;*

*“(b) all types of contract and agency arrangement, other than outright sale and purchase of goods and property in the ordinary course of business;*

*“(c) consultancy, technical and professional services;*

*“(d) management services;*

*“(e) commissions; and*

<sup>3</sup> Taofeeq Abdulrazaq (2016) Cases and Materials on Nigerian Taxation. EBC Explorer. Companion resources for legal research. Pp. 127

<sup>4</sup> Federal Inland Revenue Service: Further Explanatory Comments on Withholding

Tax principle and operation. Information No. 2006/02.

<sup>5</sup> Companies Income Tax (Rates etc of Tax Deducted at Source (Withholding Tax) Regulations 1997.



*(f) interest and royalty.*<sup>6</sup>

The Federal Inland Revenue Service (**FIRS**), the body charged with the responsibility of administering the various taxes and tax laws in Nigeria, holds the view that the classification – all types of contract activities and arrangements, other than outright purchase/sale of goods and property - is wide enough to capture every transaction other than outright sale/purchase of goods and property. What this means is that a charter party arrangement which is neither an outright sale nor purchase of goods and property in the ordinary course of business but the leasing of property to a third party falls under the category of transactions for which WHT should be charged.

It could be argued that a charter party arrangement between a ship owner and a charterer which is involved in the oil and gas industry is not a transaction in the ordinary course of business. Although the legislation does not define the term 'ordinary course of business', the FIRS explains that majority of the activities carried on in the oil industry are done by way of *contractions* and should properly fall under the category of *all types of contract and agency arrangement, other than outright sale and purchase of goods and property in the ordinary course of business.*<sup>7</sup> Thus, where a maritime services company provides a vessel to an oil and gas company through a charter party arrangement, such arrangement is liable to WHT. An example is where XYZ Nig. Limited leases its vessel to Total Nigeria Limited under a time charter arrangement, such transaction will be liable to WHT.

The issue of contracts and transactions, not being conducted in the ordinary course of business, has over the years been subjected to series of reviews and amendments aimed at improving the WHT system in order to achieve efficiency as well as minimize the cost of doing business.

Following from the points above, it is important to consider the WHT implication on a transaction that involves a maritime services company leasing a vessel from Company A under the charter party arrangement and thereafter leasing the same vessel to Company C under another distinct charter party arrangement? Considering that there is a common party in both transactions, the question arises whether this is a tripartite transaction of sorts. The FIRS sheds more light on this scenario in its Explanatory Comments as follows:

*"(a) Where there is a dual relationship between parties in a business transaction*

*This may occur for example, where a manufacturer/producer requires raw materials from a supplier for its production. This is dual relationship between both parties and the transaction will not be liable to WHT. Instances where this situation may occur include where a farmer supplies groundnut to a manufacturer of groundnut oil or where a manufacturer of glass supplies bottles to a bottling company or soft drink manufacturer or where an oil marketing company supplies diesel direct to a user.*

*(b) Where there is a tripartite relationship between parties in a transaction.*

<sup>6</sup> Schedule 1 of the Companies Income Tax (Rates etc of Tax Deducted at Source (Withholding Tax) Regulations 1997.

<sup>7</sup> Federal Inland Revenue Service: Further Explanatory Comments on Withholding Tax principle and operation. Information No. 2006/02.



*In a tripartite contract relationship involving a manufacturer, supplier and agent, there could be either two options, depending on the level of financial arrangement. For example, where Manufacturer A, engages Agent C to procure or source for raw materials from Supplier B, for his production line, there is a tripartite arrangement here. There is nothing preventing Manufacturer A from dealing directly with supplier B in order to achieve a dual contract relationship. The taxation of this sort of transaction can be explained in two limbs as follows: (i) If Agent C is mobilized by Manufacturer A with fund to source for materials for its operation, there will be need to segregate the service cost from the entire contraction, and only the service component will be liable to WHT; (ii) If Agent C, entirely finances the sourcing of the raw materials for Manufacturer A, the entire contract value will be liable to WHT at the time of payment.”*

The implication of the explanation of FIRS explanatory comments on the scenario given above is that both transactions are considered as two independent transactions and therefore, WHT will apply to each independent transaction.

### ***Nigerian Content Development Levy***

The Nigerian Oil and Gas Industry Content Development Act (**NOGICDA**) was enacted April 22, 2010 by the Federal Government. It provides for the development of Nigerian content in the Nigerian Oil and Gas industry. To this end, NOGICDA stipulates that a 1% Nigerian Content Development (**NCD**) levy is applicable on every contract awarded to any operator, contractor, subcontractor, alliance partner or any other entity involved in any project, operation, activity or

transaction in the upstream sector of the Nigeria oil and gas industry.<sup>8</sup>

Although NOGICDA provides that the NCD levy should apply to contracts in the upstream sector, the Act did not define the term “upstream sector.”<sup>9</sup> There is also no clarification in the Act on what constitutes “any project, operation, activity or transaction in the upstream sector.” Thus, where the maritime services company leases a vessel to the oil and gas company under a charter party arrangement, based on the nature of the transaction, the transaction will be subject to NCD levy. This is because in many transactions in the oil and gas industry, the contractor is the main party who procures the contract and where he procures the services of another to transport oil and gas for him, such a party is referred to as the subcontractor therefore making the transaction charter party arrangement between himself and the company providing the vessel liable to the payment of NCD levy. What this therefore means is that the contractual arrangement between the contractor and the entity awarding the contract is subject to NCD levy while the arrangement between the contractor and the subcontractor is also subject to NCD levy as both contractual arrangements fall within the ambit of NOGICDA.

The Nigerian Content Development and Monitoring Board (**NCDMB**), the government body responsible for administering the provisions of the NOGICDA further issued Guidelines pursuant to Section 70(i) of the NOGICDA. Paragraph 4.0 of the Guidelines stipulates that:

<sup>8</sup> Section 104(2) of NOGICDA

<sup>9</sup> Section 104(2) of NOGICDA



*“Mandatory contributors to the Fund include- All operators, contractors, subcontractors, alliance partners and any other companies including but not limited to exploration and producing companies, gas producing, compressing and processing companies, EPC and EPCI Companies, Original Equipment Manufacturers (OEMs). All other service companies involved in the upstream sector of the Nigerian Oil and Gas Industry”*

The Guidelines of the NCDMB expands the definitions of the Section 104(2) of the NOGICDA to cover all contracts awarded by both exploration and production (E&P) and service companies in the oil and gas industry. It must however be noted that “Guidelines” are simply “rules or instructions that are given by an official organisation telling you to do something, especially difficult.”<sup>10</sup> Guidelines are not subsidiary legislations.<sup>11</sup> In the event of conflicting provisions between the Act and the Guidelines, the provisions of the Act will supersede.

### ***The Cabotage Surcharge***

The Coastal and Inland Shipping (Cabotage) Act, 2003 provides for the payment of a cabotage surcharge by stipulating that *“there shall be paid into the Fund a surcharge of 2 per centum of the contract sum performed by any vessel engaged in the coastal trade.”*<sup>12</sup> It is essential to note that the surcharge has to be paid by a vessel engaged in the business of coastal trade. Section 2 of the Cabotage Act defines coastal trade as:

*“(a) The carriage of goods by vessel, or any other mode of transport, from one place in Nigeria or above Nigeria waters to any other place in Nigeria or above Nigeria waters, either directly or via a place outside Nigeria and includes the carriage of goods in relation to the exploration, exploitation or transportation of the mineral or non-living natural resources of Nigeria whether in or under Nigerian waters;*

*(b) The carriage of passengers by vessel from any place in Nigeria situated on lake or river to the same place, or to any other place in Nigeria, either directly or a place outside Nigeria to the same place without any call at any port outside Nigeria or to any other place in Nigeria, other than as an in -transit or emergency call, either directly or via a place outside Nigeria;*

*(c) The carriage of passengers by vessel from any place in Nigeria to any place above or under Nigerian waters to any place in Nigeria, or from any place above Nigerian waters to the same place or to any other place above or under Nigerian waters where the carriage of the passengers is in relation to the exploration, exploitation or transportation of the mineral or non -living natural resources in or under Nigerian waters; and*

*(d) The engaging, by vessel, in any other marine transportation activity of a commercial nature in Nigerian waters and, the carriage of any goods or substances whether or not of commercial value within the waters of Nigeria”*

Thus, for the cabotage surcharge to be due and payable, the contract needs to have

<sup>10</sup> Ogunniyi v. Hon. Minister of FCT & Anor (2014) LPELR – 23164 (CA).

<sup>11</sup> Comptroller General of Customs & ORs v. Gusau (2017) LPELR – 42081 (SC).

<sup>12</sup> Section 43 of the Coastal and Inland Shipping (Cabotage) Act, 2003.

been performed by a vessel engaged in the carriage of goods or passengers whether or not of commercial value in relation to the exploration, exploitation or transportation of the mineral or non-living natural resources in or under Nigerian waters, or other marine transportation activity of a commercial nature in Nigerian waters. The leasing of a vessel to a third party (whether under a time charter or a voyage charter) is of such that falls under the ambit of being a contract for the carriage of goods or passengers in relation to the exploration, exploitation or transportation of the mineral or non-living minerals in or under Nigerian waters or other marine transportation activity of a commercial nature in Nigerian waters and is liable to the payment of cabotage surcharge.

#### ***Value Added Tax***

Value Added tax is a tax imposed on the supply of goods and services. It is otherwise known as a consumption tax. Thus, where a maritime services company offers the services of its vessel to a third party, such arrangement shall be liable to the payment of Value Added Tax especially as this is not a transaction which falls under the goods and services exempt from the payment of Value Added Tax as provided in the First Schedule to the Value Added Tax Act. It should be noted that this used to be 5% of the value of the entire transaction. However, since the enactment of the Finance Act, the tax applicable shall be computed at the rate of 7.5%.

#### **4. CONCLUSION**

Based on the foregoing, it is clear that a charter party arrangement is liable to tax as it falls within the ambit of the legislations of WHT, Cabotage, VAT and NOGICDA (where the charter arrangement is provided for an entity in the oil and gas industry).

