RETHINKING THE TAXATION OF DEMURRAGE INCOME IN NIGERIA

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ABSTRACT

The classification of demurrage and detention charge earned by shipping companies on the late return of their container by vessel charterers as a non-freight income and its treatment under the provision of the Companies Income Tax Act (CITA) is a major concern to shipping companies. The Federal Inland Revenue Service considers demurrage as an income chargeable under the CITA while shipping companies regard it as part of shipping income earned in respect of inbound operation which should not be taxed, as inbound freight income is not taxable in Nigeria. The OECD Model Tax Convention on Income and on Capital and the U.N. Model Income and Capital Tax Convention support the position of the shipping companies by classifying demurrage as shipping income. The thrust of this paper is to analyse this unsettled issue and suggest a workable solution within the existing local legal framework in the shipping industry. This paper also examines the power and discretion conferred on the FIRS by section 14(3) CITA to determine a fair percentage for computation of assessable profit of shipping companies, and submits that the discretion so conferred on the FIRS is not absolute and should be exercised with regard to the peculiar circumstances of each case.

Keywords: *Taxation, Demurrage, Detention Charge.*

INTRODUCTION

The nature of international shipping business dictates the need for international shipping companies **('ISC')** to comply with laws of various jurisdictions where they operate. Taxation, being a statutory matter, is always a major consideration for the ISC. They may be required to pay tax more than once on the same income to different revenue authorities, particularly where there is no double taxation agreement between the concerned jurisdictions. ISC may also have the obligation to pay tax on its global incomes, which may include incomes derived from another jurisdiction, to the revenue authority of its home country, the place where the company was registered, on the principle of residence; and may also be liable to pay tax on the same income to the revenue authority of another jurisdiction because the income is derived from that other jurisdiction. The unique features of international shipping business justify the need for a special tax regime in section 14 of the Companies Income Tax Act **('CITA')**.[1]

The freight incomes of ISC are classified into inbound and outbound under CITA to provide clarity in the computation of tax liability of ISC. The inbound freight income is the income derived by ISC from carriage of passengers, livestock and mail to Nigeria, while the income derived from carriage of passengers, livestock and mail out of Nigeria is known as outbound freight income. The inbound freight income is taxable in another jurisdiction while the outbound freight income is taxable in Nigeria. While there is a reasonable degree of clarity in the tax treatment of inbound and outbound freight incomes under section 14 of CITA, there are, however, unsettled issues in the treatment of related incomes such as demurrage and detention charge, which are derived by ISC in the course of their business activities.

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1. Cap. C21, Laws of the Federation of Nigeria 2004.

The focus of this paper is to examine the tax treatment of demurrage income in Nigeria, and how the lingering controversy may be resolved. It is noteworthy that while the OECD Model Tax Convention on Income and on Capital has comprehensively addressed the tax treatment of demurrage income, the Convention remains of persuasive authority, and the Federal Inland Revenue Service (FIRS) may conveniently depart from it as same has not been domesticated in Nigeria.[2] The need to explore and find a workable solution to the lingering issue from the local regulatory framework becomes necessary and is further justified.

For convenience purpose, this issue shall be discussed under the following questions:

a. Is demurrage a shipping income?
b. Is demurrage received by an ISC in respect of inbound freight incomes taxable in Nigeria?
c. Are there other instances where an ISC will be liable to tax in Nigeria under a different section of CITA apart from section 14?

IS DEMURRAGE A FREIGHT/SHIPPING INCOME?

The proper description of the demurrage as either a freight or non-freight income is central to the determination of its tax treatment. The classification of general incomes of an ISC into freight and non-freight income is necessary to determine the extent of tax liability of the ISC. The description of the demurrage shall be premised on statutory and dictionary definitions as well as reasoning from the provisions of CITA and related statutes.

The definition of demurrage from law dictionaries seems to provide a good premise to start this analysis. The Black Law Dictionary[3] defines contract demurrage as:

> The sum paid by a vessel's charterer if the time to load or unload the vessel at port takes longer than that agreed on in the charterer's contract with the ship owner

An online law dictionary[4] defines it as:

> the sum which is fixed by the contract of carriage, or which is allowed, as a remuneration to the owner of a ship for the detention of his vessel beyond the number of days allowed by the charter-party for loading and unloading or for sailing

In a strict legal sense what is commonly referred to as demurrage in Nigeria, in the sense of payment made to a shipowner for delay in returning his container is actually a 'detention charge' or 'damages for detention of container'. In the case of *African Container Express v The Tourist Company,*[5] Belgore CJ. stated as follows:

> Demurrage in law according to the accepted maritime usage denotes the allowance payable to the owners of a ship by the freighter for delaying the ship in a port after the agreed time for her sailing. But some statues have extended the meaning of demurrage to include payment made in respect of delays of other means of transport other than ocean vessel, such statute as the London and North Western Railway Company (Races and Charges) Order Confirmation

2. See Section 12 of the Constitution of the Federal Republic of Nigeria 1999.
3. (9th Edition) 498.
4. The Law Dictionary, <https://thelawdictionary.org/demurrage> accessed 10 May 2018.
5. 1987-1990 Vol 3, Nigerian Shipping Cases 268 at 271.

> Act 1891. I am not however, aware of any such statute in Nigeria extending the meaning of demurrage to include payment in respect of delay in delivery of a container, nor was I given any evidence of usage of the word to include such payment. The conclusion I am led to draw from this is that the claim is a claim for damages for the detention of the Plaintiff's container by the Defendant…

This writer contends that if there was no "accepted maritime usage" of the word 'demurrage' meaning payment in respect of delay in delivery of a container in 1988,[6] the word has certainly gained such recognition now. The writer will therefore, in this paper, stick to the general sense of the use of the word 'demurrage' to mean both payment for detention of a vessel beyond the number of days allowed by agreement, and payment made by a consignee in respect of delay in redelivery of containers to a shipowner. The distinction between demurrage and damages is that while demurrage is a liquidated amount, the other is an unliquidated one.[7]

What is significant in the strict legal definition of the term, and implied in the accepted maritime usage, is that demurrage is the sum 'fixed by the contract of carriage' or the sum payable by the charterer if the time to load or unload vessel is longer than 'that agreed on in the charterer's contract with the shipowner'. This, thus, explains the consensual nature of demurrage; parties must have agreed on what would constitute demurrage and when the demurrage would arise at the start of the contract of carriage. A bill of lading is usually the evidence of the contract between the shipowners/carriers, the shipper/consignor on the one part and the consignee/endorsee on the other part.[8] Put in another way, the bill of lading is an agreement between the carrier and the consignee for the delivery of goods mentioned in the bill of lading and it is binding between the parties.[9]

In practice, the time for return of containers, and the penalty to pay for failure to return within time is not expressed in the bill of lading but in a collateral contract which may be referenced in the bill of lading and given effect to by it. The bill of lading, or any other documents used in the carriage of goods usually states the period within which the containers must be returned to the shipowner. Demurrage only arises where the owner of the goods fails to return the containers within the stipulated period. Demurrage is an economic sanction imposed by the shipowner for late return of the containers. The economic sanction/penalty is justifiable on the ground that the shipowner could have used the containers for another customer and earned an income from the usage. The income which the ISC was denied due to the late return of containers is being compensated with the demurrage. It is therefore possible for an ISC to carry on business without earning demurrage income if all its customers return containers within the stipulated period.

The key point is that demurrage is not a separate business; it is an integral part of the shipping business. There cannot be a demurrage if there is no contract of carriage of goods. But there can be contract of carriage of goods without a demurrage. We therefore need to consider the following additional questions:

a. Was the ISC set up to carry on the business of leasing containers to customers for a monetary consideration?
b. Is the demurrage received by the ISC not related to the goods it carried to Nigeria?
c. Were the terms on the use of containers by customers agreed to by parties at the port of loading outside Nigeria?
d. Is it not possible for an ISC not to earn any demurrage on the use of containers?

6. Judgment was delivered in *A.C.E v The Tourist Company's* case on 31st March 1988.
7. *Prasad v Commissioner of Income Tax* (2014) 13 TLRN 31.
8. *Adesanya v Leigh-Hoegh* (1968) 1 ANLR 330.
9. *Pacers Multi-Dynamics Ltd v The M.V. Dancing Sister & Anor* (2012) LPELR-7848 (SC).

From the self-evident answers to the above questions, my view is that demurrage is part of shipping income earned by an ISC and separation of demurrage income from other shipping incomes or its classification as a non-freight income is unnecessary. The position would have been different if the ISC is solely into the business of leasing containers to customers for carriage of goods.

IS THE DEMURRAGE RECEIVED BY AN ISC IN RESPECT OF INBOUND FREIGHT INCOME TAXABLE IN NIGERIA?

Relying on the analysis above, it is submitted that demurrage is part of freight income. What we need to analyse here is the classification of demurrage income. In the same manner a freight income is classified into inbound and outbound, demurrage can also be classified into inbound and outbound. Demurrage income earned in respect of inbound freight is inbound demurrage while demurrage earned in respect of outbound freight is outbound freight.

The two classifications of the freight income are recognised by section 14(1) CITA which provides as follows:

> Where a company other than a Nigerian company carries on the business of transport by sea or air and ship or aircraft owned or chartered by it calls at any port or airport in Nigeria, its profit or loss to be deemed to be derived from Nigeria shall be the full profit or loss arising from the carriage of passengers, mails, livestock, or goods shipped, or loaded into an aircraft in Nigeria

A Nigerian company is defined in the Companies Income Tax Act[10] as any company registered in Nigeria under the Companies and Allied Matters Act. Therefore, any shipping company not registered in Nigeria is a foreign company, and its tax liability is governed by this section. A Nigerian shipping company will, however, be taxed under section 13 of the CITA, which states that "the profit of a Nigerian company shall be deemed to accrue in Nigeria wherever they have arisen and whether or not they have been brought into or received in Nigeria".

Foreign transport (shipping and airline) companies will not be taxed in Nigeria on their global incomes, but only on profit made in respect of carriage of passengers and goods in Nigeria. In other words, the profits made by these companies on carriage of goods from other countries to Nigeria are not taxable in Nigeria. The probable reason for exclusion of inbound income from taxation regime in Nigeria is that the foreign shipping company is not, really and truly, carrying on business or trade in Nigeria, as stated in section 9 of the CITA.

The taxable profit in Nigeria is that profit arising from the carriage of passengers and goods in Nigeria. It has been analysed under the first point that contract of carriage is the contact governed by the bill of lading and any other title documents used in shipment of goods. This paper has also stated that terms on demurrage are customarily agreed to by the parties, and reduced into writing in the bill of lading or any other document in the contract of carriage of goods. It is, therefore, further submitted that demurrage income taxable in Nigeria is the demurrage received by the ISC in respect of goods or passengers loaded or shipped in Nigeria, because that demurrage is in respect of contract of carriage that was concluded in Nigeria. It may, however, be difficult to trace this demurrage, if any, because demurrage is a post delivery of goods activity, and will not be received in Nigeria.

10. Section 105.

This writer is not unaware of the provision of section 9 CITA which suggests that all companies will be taxed on their global incomes. The section provides as follows:

> Subject to the provision of this Act, the tax shall, for each year of assessment, be payable at the rate specified in section 40(1) of this Act upon the profit of any company accruing in, derived from, brought into, and received in Nigeria…

This section does not distinguish between a Nigerian company and a foreign company in setting down the tax liability test. The test may be summarised in the following words: **accruing in, derived from, brought into, and received into Nigeria.**

The above section may suggest that demurrage received by an ISC, even though it is in respect of inbound goods, is subject to tax in Nigeria solely because it is received in Nigeria. This submission is arguably wrong and may not stand in view of other provisions of the CITA which show the intendment of the Act to exempt foreign companies from paying tax in respect of incomes received or brought into Nigeria. The four-way tax liability tests only apply to Nigerian companies. The most important tax liability tests applicable to a foreign company are: **accruing in and derived from.**[11] The foreign company is only liable to pay tax in Nigeria in respect of incomes it derives from a trade or a business or income that accrues to it in Nigeria.

Section 23(1)(j) of the CITA exempts profit of a foreign company brought into or received in Nigeria. The section provides as follows:

> (1) There shall be exempt from the tax –
> (j) any profit of a company other than a Nigerian company which, but for this paragraph, would be chargeable to tax by reason solely of their being brought into or received in Nigeria.

The fact that the demurrage is received by an ISC in Nigeria in respect of inbound goods does not necessarily make it a taxable income in Nigeria. The demurrage does not accrue nor is it derived by the ISC from any trade or business in Nigeria. Section 14(1) has clearly stated that the profit deemed to accrue in Nigeria is the profit arising from the carriage of goods and passengers in Nigeria. The provision of section 14 CITA is clear and unambiguous, and the Literal Rule is therefore the preferred principle of interpretation in this circumstance. This has been the approach of Nigerian courts to interpretation of tax statutes.[12]

In summary, the income received by an ISC in respect of outbound freight is taxable in Nigeria, and consequently demurrage received in respect of this freight is also taxable in Nigeria. The income received by the ISC on inbound freight, however, is not taxable in Nigeria; and consequently the demurrage received thereto is also not taxable in Nigeria, for the reasons adduced above.

Taxation of Shipping Income

Section 14(2) CITA provides as follows:

> For the purposes of the preceding subsection, where the Board is satisfied that the taxation authority of any other country computes and assesses on a basis not materially different from

11. Ade Ipaye, *Nigerian Tax Law and Administration: A Critical Review* (ASCO Prime Publications Ltd, London 2014) 291.
12. See *S.A Authority v Tax Board* (1970)1 All NLR and *Aderawos Timber Trading Company Ltd v FBIR* (1966) NCLR 416 at 422.

that prescribed by this Act the profits of a company which operates ships or aircraft, and that authority certifies:

(a)the ratio of profits or loss, before any allowance by way of depreciation, of an accounting period to the total sums receivable in respect of the carriage of passengers, mails, livestock or goods; and
(b)the ratio of allowances by way of depreciation for that period to that same total, then the full profits or loss of that period shall be taken to be that proportion of the total sums receivable in respect of the carriage of passengers, mails, livestock or goods shipped or loaded in Nigeria which is produced by applying the first-mentioned ratio to that total, and in place of any allowances to be given under the provisions of the Second Schedule there shall be allowed the amount produced by applying the second-mentioned ratio to that same total.

Section 14(2) CITA is only applicable where the ISC's shipping income is in respect of outbound freight. In that circumstance, the adjusted profit for outbound operation shall be determined by the adjusted rate of the global income (incomes from outbound and inbound freights). The capital allowance rate for outbound operations shall also be determined by the capital allowance rate of the global income. This will be applied if the tax regime of the other country from which the shipping country operates is materially similar to the provisions of the CITA.

FIRS can only resort to section 14(3) in the tax treatment of outbound freight income, where the tax administrations of Nigeria and home country of the foreign company are different from each other. In that circumstance, the FIRS can deem a fair percentage of the sums receivable on carriage of goods in Nigeria as profit derived and taxable in Nigeria. Section 14(3) CITA provides:

Where at the time of assessment, the provisions of subsection (2) of this section cannot for any reason be satisfactorily applied, the profits to be deemed to be derived from Nigeria may be computed on a fair percentage on the full sum receivable in respect of the carriage of passengers, mails, livestock and goods shipped or loaded in Nigeria:

FIRS is clothed with the discretion under CITA to determine the fair percentage for computation of assessable profit of the ISC. A fair percentage is not defined in CITA, and therefore, it could be argued that the percentage should be, in all respect, fair to the shipping company having regard to the unique characteristics of the shipping industry. In determining the fair percentage under section 14(3), there may be need to engage an industry expert to give opinion on the following key areas:

a. nature and characteristics of revenue generation in the shipping industry;
b. reasonable capital and operating expenses;
c. range of attainable profit margins; and
d. the percentage of profit that could be used by the FIRS in this circumstance which will not have a negative impact on the profitability of the shipping company and the expected returns of the capital providers.

In practice, FIRS use 20% as a fair percentage and applies it to concerned companies across all the sectors without regard to the differences in the peculiarities of each of these sectors. The 20% fair percentage is based on government policy, and has been in use since 1996. As 'fair percentage' is not defined in the CITA, it is open to several interpretations. While FIRS may be comfortable with the general application of 20%, the ISC may argue that the 20% is unfair to their sector.

The position by an ISC that the fair percentage fails to consider the economics and peculiarities of the shipping industry may, with respect, be insufficient to make FIRS depart from the current practice. We need to bear in mind that section 14(3) CITA which clothes the FIRS with the power to apply a fair percentage does not define what constitutes fair percentage. The section does not also require the FIRS to consider the economics and peculiarities of each sector in fixing the percentage.

The solace is however in the settled principle of taxation that a taxing statute is interpreted in favour of the tax payer when there is an ambiguity.[13] The fair percentage, it may be argued, is ambiguous because a flat tax rate may not be fair to all sectors in the transport industry. The ISC has the obligation to convince FIRS that the 20% is not a fair percentage by adducing expert opinions on the key issues stated above.

The FIRS power to determine fair percentage under section 14(3) is similar to its power under section 30 to determine fair and reasonable percentage in the turnover assessment of a company which profit is less than the expectation of the FIRS or does not represent the true amount of assessable profit in the opinion of the FIRS. This writer agrees with the opinion of a learned author that section 30 expects FIRS to meet the standard expected of a reasonable man having regard to the facts and circumstances of each case in the determination of fair and reasonable percentage of turnover to be assessed to tax.[14] The intendment of the law is that FIRS should ensure fairness in its approach; and this fairness cannot be ascertained by a blanket formula without regard to the peculiar circumstances of each company.[15]

It is instructive to note that the provisions of Article 8 of the OECD Model Convention on Income and Capital recognises demurrage income as part of shipping income, and should be given the same tax treatment as other shipping incomes.[16] The provisions are in support of our earlier submission, but they only have persuasive force in Nigeria. These provisions have not been domesticated into our local laws,[17] and are therefore inferior to the provisions of section 14 CITA. It is respectfully recommended that a foreign shipping company which finds itself in this situation should maintain the submission on the first issue, but without prejudice to the provisions of OECD and UN models as supporting arguments.

ARE THERE OTHER INSTANCES WHERE AN ISC MAY BE LIABLE TO PAY TAX UNDER A DIFFERENT SECTION OF CITA APART FROM SECTION 14?

An ISC may be liable to pay tax under a different section of CITA other than section 14 if its trading activities from which profit was derived are not related to shipping activities. In this circumstance, the special provisions contained in section 14 will be inapplicable, and the ISC will be liable to pay tax on its global income under the provisions of sections 9 and 13 CITA. There may not be any disagreement on the tax treatment of this income as same will be computed under the general tax provision of the CITA.

13. M.T. Abdulrazaq, *Revenue Law and Practice in Nigeria* (2nd edn., Malthouse Press Limited, Lagos 2010) 11.
14. Maxwell Ukpebor, 'Turnover Assessment: Tax Treatment of Recharges under the Companies Income tax Act' (2016) 7(2) The Gravitas Review of Business and Property Law.
15. *Ibid.*
16. See Commentary on Article 8 of the Condensed Version of the Model Tax Convention on Income and on Capital as it read on 21 November 2017. Some countries, such as Greece and Portugal, however reserve their position on the application of this Article. The position of the Article seems to represent the view of the majority of the countries.
17. See section 12 of the 1999 Constitution, Cap. C20, Laws of the Federation of Nigeria, 2004.

CONCLUSION

It is recommended that the FIRS should adopt the position of the OECD and UN Model Conventions on Income and Capital, which appear to be a true representation of the nature and characteristic of demurrage in the shipping industry, and the international community's perception of the demurrage. In doing so, demurrage received by an ISC in respect of inbound operation should be treated as part of inbound freight income and exempted from taxation. ISCs may be constrained or prefer to abandon the Nigerian market and operate in other jurisdictions where demurrage is treated in accordance with the OECD and UN Model Conventions on Income and Capital. This may consequently affect competitiveness of the Nigeria shipping industry, and reduce the contribution of that sector to the country's Gross Domestic Product.

It is also suggested that the 20% adopted as the fair percentage of assessable profit of outbound operation, which has been in use for over two decades, is due for review. The general application of the 20% to foreign companies does not represent fairness and reasonableness expected by sections 14(3) and 30 of CITA. FIRS may therefore adopt different rates for each sector, and the rate should consider the peculiar characteristics and economics of each sector.