

Accounting for VAT in Nigeria

Cash or Accrual basis?

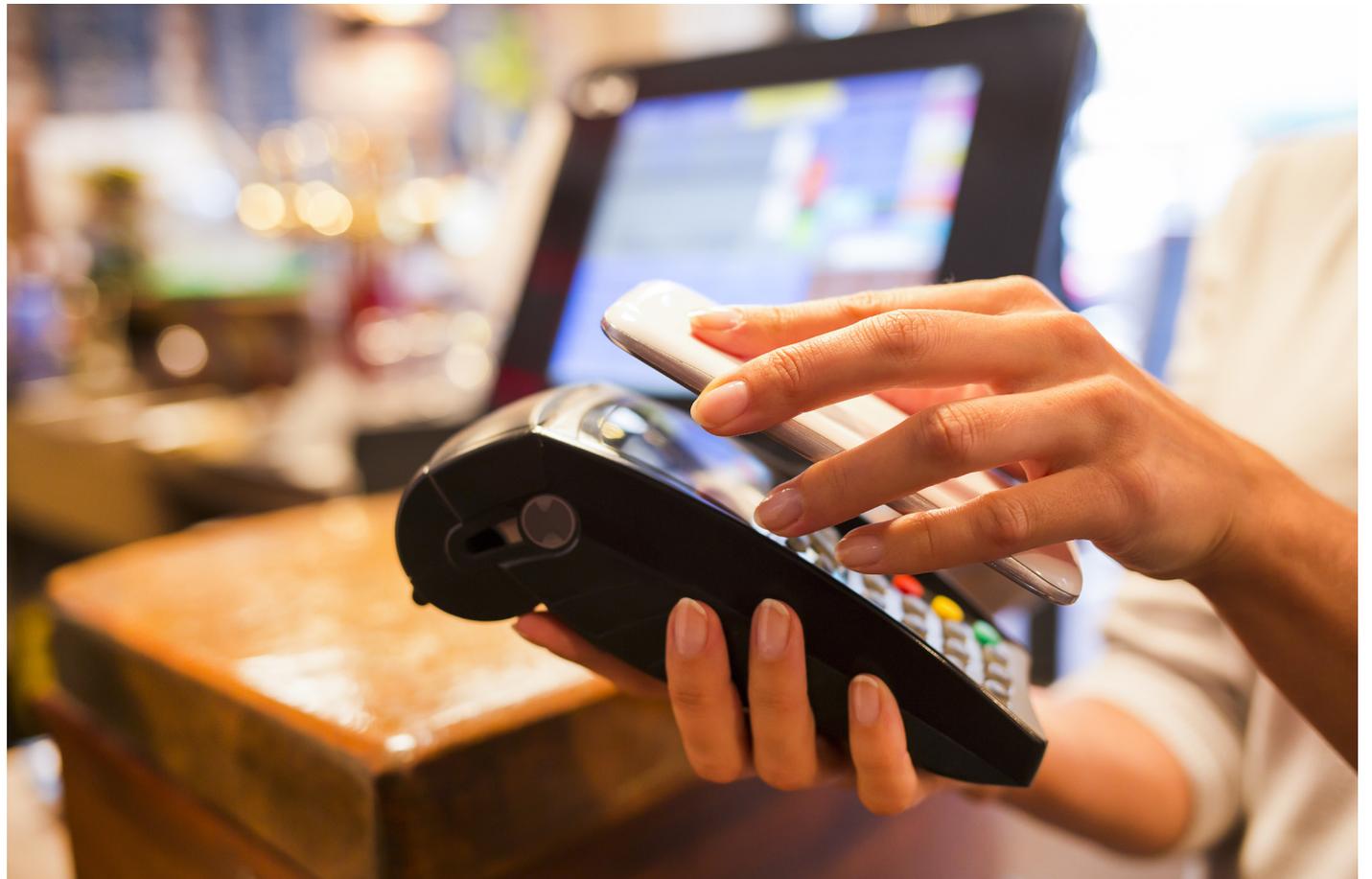
The Value Added Tax Act (VATA or the Law), 2007 governs the administration of VAT in Nigeria. VAT is levied at each stage of the production chain at 5% of the value of the taxable good or service¹ supplied, but it is eventually borne by the final consumer, being a consumption tax.

The VATA contains provisions which appear to support both the cash and accrual basis of accounting for VAT. The accrual basis requires taxpayers to account for VAT upon issuance of an invoice without involving the transfer of cash. On the other hand, the cash basis requires taxpayers to account for VAT on the basis of cash received.

Section 15 of the VATA provides that *"a taxable person shall render to the Board, on or before the 21st day of the month following that in which the purchase or supply was made, a return of all taxable goods and services purchased or supplied by him during the preceding month in such manner as the Board may from time to time, determine."*

The above section would appear to support accrual basis of accounting for VAT and implies that VAT should be accounted for on every transaction made in the preceding month, whether or not payment has been made or received. Also, the section appears to suggest that VAT charged on transactions of a taxable person², should be paid to FIRS on or before 21st day of the following month.

On the other hand, Sections 12(1-2), 14(1-2) and 16 appear to create the basis for accounting for VAT on cash basis. Section 12(1) of the VATA stipulates that *"a taxable person shall pay to the supplier, the tax on taxable goods and services purchased by or supplied to him"* and Section 14(1) provides that *"a taxable person shall on supplying taxable goods or services to his accredited distributor, agent, client or consumer, as the case may be, collect the tax due on those goods or services at the rate specified in section 2 of the Act"*. The tax collected under Section 14(1) is referred to as output tax under VATA. In addition, Section 16 of the VATA states that the **VAT payable will be the net of**



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output VAT and the VAT paid (input VAT), where allowable.

It can be inferred from the above provisions that where a taxable person has not collected any output VAT, it does not have to remit any VAT to Federal Inland Revenue Service (FIRS). Thus, implying that accounting for VAT could be based on VAT collected from customers and VAT paid to vendors.

In practice, the basis adopted by taxpayers usually depends on the approach that best suits the nature and quantum of their business operations. A lot of Nigerian companies account for VAT on accrual basis due to the simplicity of this method and the fact that it aligns directly with basic accrual accounting. However, this may have implication for such companies' cash flow management strategies as

they may have to borrow money to pay VAT where distributor are yet to settle invoices raised by such companies. Further, there is the risk of over remitting VAT under this basis particularly where a debt becomes bad and VAT element of such bad debt is never adjusted against future VAT filings returns.

Few companies adopt the cash basis of accounting for VAT especially those with small operations. This basis however requires reconciliation between the turnover per account and actual money received and tracking of input VAT as well.

Though FIRS has been known to prefer the accrual basis of VAT remittance, for obvious reasons, the cash basis for accounting for VAT is more aligned with the realities of doing business in Nigeria. Most companies have

payment cycles which span beyond the 21 days ultimatum provided in the VATA (typical payment cycles range from 30 to 90 days). Where a taxpayer does not receive payment for supplies made/ services rendered before the deadline date of rendering VAT returns, there may be a need for the tax payer to source for funds elsewhere, in order to fulfil its VAT obligations.

The revised National Tax Policy (NTP) prescribes that the tax system should promote fairness, low compliance cost, etc. Presently, the cash basis aligns with these objectives. It is noteworthy that the NTP Review Committee recommends that Nigeria's VAT system should operate on a cash basis rather than on an accrual basis to eliminate the challenge of VAT recoverability on credit sales (especially if the debt goes bad).

Our expectations remain that existing tax legislation will be aligned with the stipulations of the revised NTP so that areas of disconnect or ambiguities will be eliminated speedily.

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Contact

Oluseye Arowolo
Partner
Tax & Regulatory Services
oarowolo@deloitte.com.ng

Yomi Olugbenro
Partner
Tax & Regulatory Services
yolugbenro@deloitte.com.ng

Patrick Nzeh
Partner
Tax & Regulatory Services
pnzeh@deloitte.com.ng

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¹ Taxable goods and services means the goods and services not exempted from VAT

² Taxable person includes an individual or body of individuals, family, corporations sole, trustee or executor or a person who carries out in a place an economic activity, a person exploiting tangible or intangible property for the purpose of obtaining income there from by way of trade or business or a person or agency of government acting in that capacity.