

Court of Appeal affirms educational institutions' companies income tax obligation

The Court of Appeal (CoA), in December 2018, upheld the ruling of Federal High Court (FHC) on the liability of educational institutions to pay companies income tax (CIT). The judgement arose from an appeal by Best Children International Schools Limited (BCIS/the Appellant) against Federal Inland Revenue Service (FIRS) in respect of the FHC decision that BCIS' profits do not qualify for exemption under Section 23(1)(c) of Companies Income Tax Act (CITA).

Background

In 2014, FIRS assessed BCIS to CIT and tertiary education tax (TET). BCIS challenged this by instituting an action at the FHC. The FHC decided in favour of FIRS on the premise that BCIS is a company limited by shares (CLS) and thus not an educational institution with public character.

BCIS appealed the decision, urging the CoA to determine the appropriateness of FHC's reliance on Section 26 of Companies and Allied Matters Act (CAMA) in determining its exemption status under CITA and to provide an injunction restraining FIRS from enforcement of the assessment on the Appellant.

The CoA upheld the FHC decision declaring that BCIS is liable to tax as it was not registered as a company limited by guarantee (CLG). According to the CoA, a CLS is for profit making and must pay income taxes. The fact that BCIS is a school or an educational institution is not enough to exempt it from payment of taxes.

Analysis and implications of the decision

Section 23(1)(c) of CITA exempts "profits of any company engaged in ecclesiastical, charitable or education activities that are of public character and the profits are not derived from a trade or business carried on by such company."

In view of the above, I have examined the conditions and considerations for exemption below:

Nature of activity: the activities must be educational in nature. Although not defined in CITA, educational



activities are easy to determine and BCIS was able to demonstrate it carries out educational activity.

Activities must be of public character: CITA does not define "public character", thus its interpretation often generates issues. The CoA ruled that BCIS did not prove that its educational activities are of a "public character", thus the exemption is inapplicable. Moreover, the Appellant's proprietor introduced herself as a member of the National Association of Proprietors of Private Schools.

In a similar case between American International School (AIS) and FIRS, brought before the Tax Appeal Tribunal (TAT) in 2015, FIRS sought to levy CIT on AIS on the grounds that it was not an educational institution of "public character", even though AIS was registered as a CLG. This is because the services rendered by AIS were for a fee and could not be said to be available to every Nigerian.

AIS argued that its activities are of a "public character" using an analogy of "institution of a public character" as defined in Paragraph 9 of the Requirements for Funds, Bodies or Institutions Regulations, 2011, pursuant to FIRS' Establishment Act, which defines such body as "a body or institution whose activities are meant to benefit Nigerians in general and particularly the public and its profits are not available for distribution to

its promoters".

TAT ruled in favour of AIS, on the following bases:

- No segment of the Nigerian public was excluded from the services rendered by AIS – FIRS did not provide any evidence of exclusion of any segment
- AIS' profit/income was not distributed to AIS' directors or guarantors
- AIS derives profit only from educational services.

The above presupposes that an entity would be able to claim "public character" if no segment of the Nigerian public is excluded from benefiting from its educational activities.

This then raises the question of the extent of exclusion that will negate "public character" – would gender ("girls-only" or "boys-only"), special needs, foreigners only etc., constitute exclusion of any segment of the Nigerian public from having access to educational services? Additionally, does the fee charged by the schools ensure availability to all segments of the Nigerian public, or does it ensure that only the segment of the public that pays enjoys the benefit?

Non-derivation of profit from a trade or business:

One of the bases of CoA's decision was that BCIS failed to prove that its profit was not from a trade or business.

Simply put, trade is a business carried on for

profit purpose. Thus, applying CITA strictly, offering educational services at a fee with a view to making profit would constitute a trade/business which negates the exemption.

Notwithstanding, applying this strict interpretation would be counter-productive, as Section 23(1)(c) of CITA is an exemption provision. It envisages that educational institutions would make profits, it only exempts those profits from tax. This view was given credence in AIS v FIRS where TAT held that charging fees for educational services is not strange to the income generation activities of a school.

Considering that educational entities are mere artificial persons holding interest of promoters, ability to distribute profits from the trade to ultimate beneficiaries becomes important. This, in my view, forms the basis of taking cognizance of modality of set up.

Thus, CoA's focus on the form of registration (which ultimately affects distribution to promoters) in BCIS v FIRS appears to be in order. One of the grounds of dismissing the appeal is that BCIS did not prove that it was registered as a CLG (proscribed from distributing profits to promoters). Rather, it was presented by FIRS as a CLS (permitted to share profits to shareholders).

One perspective on this is consideration of what happens if a CLS does not distribute profits and has no intention of distributing profits and documents this

fact in its Memorandum and Articles of Association (MEMART). Would such educational institution then be considered to be of public character? In my view, this should not absolve such companies as the MEMART may be amended while the restriction under a CLG or incorporated trust is pursuant to a law which is not under the control of the promoters.

Conclusion

Educational institutions (with the ability to distribute profits to promoters or shareholders) in Nigeria may no longer be able to enjoy income tax exemption on the basis of carrying out educational activities alone. Ability to share profits (driven by mode of registration) appears to be a prerequisite for determining "public character" and ultimately, tax exemption.

Furthermore, the treatment of ancillary income from other activities (transportation and sale of books and uniforms) carried out by schools may come under more scrutiny. The jury is still out on whether these activities qualify as "other trade or business" or an extension of "educational services".

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