

DYNAMICS OF AVIATION TAXES IN NIGERIA



In Nigeria, residence-based and source-based taxation of airlines apply. For resident individuals and companies, taxation is based on global profits and therefore residence based. For non-resident companies, their exposure to Nigerian taxes arises from the carriage of passengers and goods loaded into their aircrafts in Nigeria. This position applies where the non-Nigerian company carries on the business of transportation by air whether the aircrafts used are chartered or owned.² Notably, the law makes an exception for passengers and goods brought into Nigeria for trans-shipment. As it the case with other industries, where actual profits from air transportation cannot be ascertained, the tax authorities are empowered to assess the company to tax on the basis of deemed profits. Companies assessed on deemed profits have a six-year window to apply for their profits to be recomputed on actuals. In any case, the tax liability must be at least two per cent of the full sum receivable in respect of the carriage of passengers and goods loaded into aircrafts in Nigeria. In determining applicable taxes and rates, the law make a distinction between air transport profits and business profits. Specifically, the law³ provides that income arising from leasing, containers, non-freight operations and other incidental income fall to be taxed under the general provisions on taxation of profits accruing in, derived from, brought into or received in Nigeria. As such, incidental income would be subjected to the tax treatment ordinarily applied to such classes of income. Taxation on leases is of particular importance to the aviation industry as many airlines source their aircrafts through leases. The distinction between finance leases and operating leases with the lessee in the former being granted capital allowances for depreciation etc., also applies in the aviation industry. Lease rentals are also subject to withholding tax obligations. This tax, when levied on a non-resident company, signifies the final tax.

Generally, aviation taxes are complex. With airlines flying across territorial jurisdictions and spending only a portion of their total distance in any particular sovereign state, the question of when and how to tax their income arises. Internationally, exclusive residence-based taxation of airlines is favoured over source-based taxation. Accordingly, Article 8 of the United Nations Model Tax Treaty 2021 which mirrors Article 8 of the OECD Model Tax Convention provides that taxing rights belong to the contracting state of the enterprise (airline). This is based on the consideration that exposure to tax in each of the jurisdictions where airlines make a stopover or lift passengers and goods may lead to multiple taxation even when such airlines may be in an overall loss position. Moreso, taxation of the industry gives great consideration to reciprocity and volume. IATA, in putting forward its position on BEPS Action 13 and seeking an exemption for airlines from the country-by-country reporting noted that source-based taxation on gross receipts or turnover does not take into account the profitability of the airline in the source state.¹

¹ IATA'S Response to OECD Action Plan 13 [cbc_reporting.pdf \(iata.org\)](https://www.iata.org/en/pressroom/2022/02/16/13-cbc-reporting) accessed 16 February 2023.

² Companies Income Tax Act CAP C 21 LFN 2004 section 14.

³ Finance Act (FA) 2023 section 8.

While the Companies Income Tax Act is silent on the tax implications of wet and dry leases, the Federal Inland Revenue Service through its explanatory circulars on aviation⁴, advise that profits accruing from wet leases will be considered to constitute air transportation profits while profits from dry leases will fall under business profits. Importantly, where the affected airline is resident in a treaty partner country and the treaty expressly specifies a different tax treatment for either lease, the treaty provisions shall override. Aviation loans are also taxed in line with the rules governing taxation of loans in Nigeria. Interest payments are subject to withholding taxes with taxes withheld from non-residents considered final taxes. Importantly, foreign loans may enjoy up to seventy per cent interest tax exemptions based on the repayment period and moratorium.

In recent years, the Federal Government has given certain tax concessions to players in the aviation industry. Particularly, commercial aircrafts, commercial aircraft engines and commercial aircraft spare parts are exempted from the payment of value added tax.⁵ Further, Nigerian registered airlines that provide commercial air transport services are entitled to import their aircrafts, engines, spare parts and other components duty-free.⁶ While non-residents will not be caught by capital gains tax obligations, Nigerian residents are liable to remit tax on gains from disposal of aircrafts. In determining the location of an aircraft for capital gains tax, the law provides that aircrafts used for international traffic are considered to be situated in Nigeria if the owner is resident in Nigeria.⁷ This also applies to interests and rights in or over aircrafts. Where the person entitled to the interest or right is resident in Nigeria, such interest or right will be deemed situated in Nigeria.

Airlines generate income in a variety of ways. In addition to income generated by lifting passengers and goods, other income sources include services to other airlines, advertising, container leasing and other incidental income. Treatment of these income in the absence of double tax treaties will undoubtedly expose non-resident companies to more taxes. While

the Companies Income Tax Act makes special provisions for tax assessments of companies in countries where air transport taxes are computed similar to the Nigerian position, the provisions of the Act alone do not sufficiently cover the intricacies of the industry. Airlines resident in treaty partner countries will therefore earn an advantage over non-treaty countries. Where tax treaties exist and there is reciprocity, full exemptions would apply. Tax treaties may also apply where there is no reciprocity with only the foreign treaty partner's airlines flying in and out of Nigeria. In such cases, the foreign company may obtain only a reduced rate of income tax. With the limited presence of Nigerian based air carriers in the international air space, the international position of exclusive residence-based taxation may still be a little far-fetched without a corresponding number of airlines to take advantage of reciprocity. It is expected that the government will continue along the path of creating a tax enabling environment for industry players.

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⁴ Taxation of Companies Engaged in Shipping, Air Transport and Cable Undertakings, <http://firs.gov.ng/wp-content/uploads/2021/06/> accessed 13 February 2023.

⁵ Value Added Tax Act CAP V1 LFN 2004 (as amended) First Schedule, Part 1.

⁶ FA 2023 section 39.

⁷ FA 2023 section 3.