STATES & LOCAL FINANCE

The IGR Initiative

MARTIN IKE-MUONSO

Martin Ike-Muonso, a professor of economics with interest in subnational government IGR growth strategies, is managing director/CEO, ValueFronteira Ltd. He can be reached via email at martinoluba@gmail.com

Effective tax dispute resolution

TAX DISPUTE RESOLUTION is core to effective tax administration and internally generated revenue expansion by further clarifying and interpreting applicable tax laws and how the implementation of those rules should be within the bounds of fairness, impartiality, and the rule of law. By strengthening taxpayers' trust in the tax administration, higher levels of tax compliance become achievable. Disputes generally refer to disagreements with taxpayers on tax liabilities and compliance with tax obligations. Typical examples could be disagreements on the correct tax treatment of a transaction or on what is legally a due tax. In addition to the traditional civil tax, disputes are criminal tax prosecutions, objections to tax assessments, the recovery of overpaid taxes, challenging administrative tax decisions, etc. Taxpayers typically comply better when there are adequate procedural and retributive fairness levels in tax administration. In the former, the expectation is that tax administrations adhere to fair procedures in dealing with taxpayers.

In the latter tax, administrations must demonstrate sufficient fairness in applying punishments where infringement on rules exists. Therefore, tax dispute resolution helps ensure the restoration of these expected levels of fairness and trust in the tax administration where there are infractions. Additionally, an effective dispute resolution mechanism also helps in engendering dispute avoidance. The reason for this is the expensive nature of tax disputes. Secondly, because the dispute resolution infrastructure typically maps out the correct route to taxpayer compliance and administrative fairness, either party always does well to avoid clashes that would require a return to the clarification of the rulebooks and the attendant financial and other inconveniencing costs.

Therefore, one of the significant considerations in evaluating the effectiveness of tax administration is assessing the quality of dispute resolution architecture available to the taxpaying ecosystem. Essentially, an efficient dispute resolution mechanism must possess a reasonable level of fairness in the process, procedures, form, and substance. That means that the taxpayer has the right to challenge a tax assessment and can independently access this justice infrastructure with the guarantee of a fair hearing on time. When necessary, such a mechanism will also be open to relevant and timely reviews. The tax dispute resolution architecture is ineffective when taxpayers cannot easily access it. Typically, taxpayers seeking redress incur varying degrees of costs depending on the size of disputed claims, length of time the dispute resolution process takes, tax dispute review with or without professional assistance, and whether there are fees for accessing the redress process. Out-of-pocket expenses such as application fees, professional assistance fees, and other personal disputes-related expenditures are generally explicit. However, the time loss's opportunity or implicit cost beyond the acceptable threshold can be high. The presence of any or all these implicit and explicit cost factors may significantly constrain taxpayers from seeking redress. Therefore, while the existence of a robust tax dispute resolution mechanism is a necessary condition, a satisfying requirement for an impartial tax dispute redress process is the minimization of these constraints to its access.

Time losses in a lengthy tax dispute resolution process can be expensive. The opportunity costs of such losses sometimes far outweigh the monetary expenses on resolving them. On aggregate, they comprise time losses of applicants and unpaid professionals and helpers. Ideally, there should be a timeframe to resolve varying types of tax disputes. That should also not provide a window for hasty decisions that might injure justice. Ideally, one should expect a time extension, such as in the lodgment of objections, but it should not impose an unnecessary cost burden.

Aside from access to a tax dispute resolution mechanism, taxpayers must possess the right to challenge tax assessments and other areas of infringement on their rights. Interestingly, the Nigerian judicial system has substantially cleared the fog in this essential criterion and subsequently provided enormous headroom for tax justice. For instance, in June 2018, the Lagos High Court, in its ruling on Chemiron Nigeria Limited versus Lagos State Board of Internal Revenue, upheld the rights of taxpayers to challenge any tax assessment of the High Court even when they fail to object to the assessment or file an appeal at the Tax Appeal Tribunal. Similarly, in the August 20, 2019, case of Polaris Bank Plc versus Abia State Board of Internal Revenue, the Tax Appeal Tribunal sitting in Enugu held that tax audits conducted by relevant tax authorities, which violate statutorily laid down procedures, are not binding on taxpayers. The Tax Appeal Tribunal also rules that taxpayers can object to a defective assessment even if paid. Consistent with the expectation of retributive justice, there should also be ample room to review dispute resolution. Any dispute parties, such as the taxpayers, can appeal Judgments on tax disputes when not satisfied. The opportunity for judicial review of judgments made on a particular tax dispute is critical in reaffirming taxpaying stakeholders' trust in the administration.

There are several triggers of tax disputes. Firstly, it can result from possible inconsistencies in the provisions of the tax laws and the attendant differing understanding and interpretations of such tax laws on the sides of both the tax authorities and the taxpayers. And unless there is appropriate clarification, unified understanding, and interpretation of tax laws regarding particular issues, disputes will persist. The second is the tax administration procedures perceived by the taxpayer as infringing on their rights. For instance, an administrative process that results in unjustified overpayment and some attendant frustration in timely reconciliation and recovery of the overpaid amounts can lead to disputes. Thirdly, the inability of taxpayers to keep appropriate records of tax transactions may lead to altercations. Despite the law mandating taxpayers to keep the records necessary for their tax assessments, many fail to do so. Such failure to comply with that record-keeping legal requirement always results in their inability to defend their tax position as required correctly. Fourth, inconsistent and wavering positions of the tax authority over some tax issues that could hurt taxpayers' transactions can result in disputes, mainly if such losses or financial risks materialize.

Based on KPMG's May 2021 tax dispute resolution survey, Nigerian taxpayers may seek judicial redress only without workable administrative resolution options and conciliatory measures. The survey findings also show that more than 50% of federal and state tax disputes are resolvable at the preliminary reconciliation stages. Unfortunately, where that fails and judicial redress becomes inevitable, it takes between a year and three years to resolve such tax disputes at both the federal and state levels of government in Nigeria. Most of the respondents also indicated their willingness to appeal judgment based on the points of law where the Tax Appeal Tribunal issues rulings in favour of the tax authority. Fundamental responsibility for tax dispute determination and resolution in Nigeria is first through the administrative channel within the tax authority and secondly with the law courts, revenue courts of various states and local governments, and the Tax Appeal Tribunal. The administrative track is ideally the first point where taxpayers access the window to challenge a tax assessment.

The Internal Revenue Service or Tax Administration may uphold this objection or otherwise. In the latter, the Internal Revenue Service usually issues the aggrieved taxpayer with a refusal notice. The aggrieved party can appeal this notice of refusal within thirty days. Of course, appeals are possible in line with the hierarchical order of court authorities in Nigeria, with the Supreme Court being the apex and final point for justice. It is important to emphasize that disputes over federal taxes such as company income tax should be presented first at the Tax Appeal Tribunal or the Federal High Court. The Tax Appeal Tribunal entertains tax disputes on personal income tax for the government's security agencies, Nigerian foreign services, and Nigerian's resident overseas but earning income from the country. The revenue courts only have jurisdiction on revenue matters arising from the state and local government laws. It also has criminal jurisdiction over tax offenders.

On the other hand, the Tax Appeal Tribunal is the establishment of the Federal Inland Revenue Service Act. Its jurisdictional powers cover federal tax laws such as the company's income tax, value-added tax, and tax laws made by the federal legislature. The state high courts also lack jurisdiction on matters of the federal government's revenue or the taxation of companies. Notwithstanding the considerable importance of tax dispute resolution mechanisms, there is no disagreement on the fact that its prevention remains a better course of action. Dispute prevention is also an increasingly global direction in tax stakeholders' relationship management. Since disputes and their resolutions are costly, prevention mechanisms provide robust corridors for better understanding and minimizing misunderstanding, considering all the parties' needs and interests. Open dialogue with the Internal Revenue Service that further clarifies the tax implications of certain transactions and business activities keeps the tax authorities properly informed and assures correctness on either party's side. Such early full disclosure puts the tax authorities on their toes as they can no longer claim ignorance of the transaction or business plan.

A complementary aspect of this early disclosure position is raising issues and obtaining clarifications before filing. In addition to early disclosures, comprehensive voluntary taxpayer disclosures facilitate access to some bonuses and create the opportunity for complete agreement on all audit specifics. Early disclosure saves tax assessors and auditors a great deal of inconvenience. The OECD's February 2021 International Compliance Assurance Program [ICAP] consolidates this tax dispute prevention mechanism into three steps: selection, risk assessment, and issue resolution and outcomes. The selection phase identifies critical issues that may lead to disputes, requiring early clarification and resolution. This phase also identifies specific offices of tax administration that should participate in reviewing them. In the second phase, the tax administration examines these issues alongside the taxpayers and makes efforts to disagree to agree on some of those identified problems. The final stage is a letter specifying the understanding between the taxpayer and the tax authorities regarding all the identified and resolved issues.

Aside from the explicit dispute prevention mechanisms, the alternative dispute resolution mechanism also supports the management of tax disputes by presenting a better channel for avoiding the expensive and time-consuming procedures in court litigations. The Nigerian National Tax Policy currently supports it. As a more flexible alternative, the alternative dispute resolution mechanism permits the disputing party's choice of experts to assist them in the resolution process. The disputing parties also possess more flexibility on the procedure, including venue options, the scope of discussions, professionals to invite, etc. The process typically consists of four distinct approaches: negotiation, mediation, conciliation, and arbitration. The choice of the disputing parties for any of these would depend on what is permissible within the extant Nigerian National Tax Policy and what is most appropriate given the tax issues in contestation.

On a final note, nothing can be more effective than processes and procedures that prevent disputes from occurring in the first instance. However, human interactions and societies generally cannot successfully exist without disagreements. Tax matters are not exempt. Where unleashing the dispute resolution process becomes inevitable, the alternative dispute resolution mechanisms present better ways of avoiding the money and time-consuming litigations that sometimes leave either of the parties feeling that they never had access to justice anyway.

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