Advanced Taxation

Study Text

The Institute of Chartered Accountants of Nigeria

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Notice

The Institute of Chartered Accountants of Nigeria has made every effort to ensure that at the time of writing the contents of this Study Text are accurate, but neither the Council of the Institute of Chartered Accountants of Nigeria, nor its management or employees shall be under any liability whatsoever for any inaccurate or misleading information this work could contain.

Professional level

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The business environment has been undergoing rapid changes caused, by globalisation and advancement in Information Technology. The impact of these changes on the finance function and the skills set needed by professional accountants to perform their various tasks have been profound. These developments have made it inevitable for the Institute's syllabus and training curriculum to be reviewed to align its contents with current trends and future needs of users of accounting services.

The Institute of Chartered Accountants of Nigeria (ICAN) reviews its syllabus and training curriculum every three years, however, the syllabus is updated annually to take cognisance of new developments in the national environment and global accoutnacy profession. The Syllabus Review, Professional Examination and Students' Affairs Committees worked assiduously to produce a 3-level, 15-subject ICAN syllabus. As approved by the Council, examinations under the new syllabus will commence with the November 2021 diet.

It is instructive to note that the last four syllabus review exercises were accompanied with the publication of Study Texts. Indeed, when the first four editions of Study Texts were produced, the performances of professional examination candidates significantly improved. In an effort to consolidate on these gains and to further enhance the success rates of students in its qualifying examinations, the Council approved that a new set of learning materials (Study Texts) be developed for each of the subjects. Although, these learning materials may be regarded as the fifth edition, they have been updated to include IT and soft skills in relevant subjects, thereby improving the contents, innovation, and quality.

Ten of the new learning materials were originally contracted to Emile Woolf International (EWI), UK. However, these materials were reviewed and updated to take care of new developments and introduced IT and soft skills in relevant subjects. Also, renowned writers and reviewers which comprised eminent scholars and practitioners with tremendous experiences in their areas of specialisation, were sourced locally to develop learning materials for five of the subjects because of their local contents. The 15 subjects are as follows:

Foundation Level		
1.	Business, Management and Finance	EWI/ICAN
2.	Financial Accounting	EWI/ICAN
3.	Management Information	EWI/ICAN
4.	Business Law	ICAN

Skills Level		
5	Financial Reporting	EWI/ICAN
6	Audit and Assurance	EWI/ICAN
7.	Taxation	ICAN
8.	Corporate Strategic Management and Ethics	EWI/ICAN
9.	Performance Management	EWI/ICAN
10.	Public Sector Accounting and Finance	ICAN

Professional Level		
11.	Corporate Reporting	EWI/ICAN
12.	Advanced Audit and Assurance	EWI/ICAN
13.	Strategic Financial Management	EWI/ICAN
14.	Advanced Taxation	ICAN
15.	Case Study	ICAN

As part of the quality control measures, the output of the writers and reviewers were subjected to further comprehensive review by the Study Texts Review Committee.

Although the Study Texts were specially produced to assist candidates preparing for the Institute's Professional Examination, we are persuaded that students of other professional bodies and tertiary institutions will find them very useful in the course of their studies.

Haruna Nma Yahaya (Mallam), mni, BSc, MBA, MNIM, FCA
Chairman, Study Texts Review Committee

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The Institute is deeply indebted to the underlisted locally-sourced rewriters, reviewers and members of the editorial board for their scholarship and erudition which led to the successful production of these new study texts. They are:

Taxation		
1.	Enigbokan, Richard Olufemi	Reviewer
2.	Clever, Anthony Obinna	Writer
3.	Kajola, Sunday Olugboyega	Writer

Business Law		
1.	Oladele, Olayiwola.O	Writer/Reviewer
2.	Adekanola, Joel .O	Writer

Public Sector Accounting and Finance		
1.	Osho, Bolaji	Writer/Reviewer
1.	Biodun, Jimoh	Reviewer
2.	Osonuga, Timothy	Writer
3.	Ashogbon, Bode	Writer

Advanced Taxation		
1.	Adejuwon, Jonathan Adegboyega	Reviewer
2.	Kareem, Kamilu	Writer

Case Study	
Adesina, Julius Babatunde	Writer/Reviewer

Information Technology Skills		
1.	Ezeilo, Greg	Reviewer
2.	Ezeribe, Chimenka	Writer
3.	Ikpehai, Martins	Writer

Soft Skills		
1.	Adesina, Julius Babatunde	Reviewer
2.	Adepate, Olutoyin Adeagbo	Writer

The Institute also appreciates the services of the experts who carried out an update and review of the following Study Texts:

Business Management and **Finance**	
1.	Ogunniyi, Olajumoke

Management Information	
1.	Adesina, Julius Babatunde
2.	Ezeribe, Chimenka

Financial Accounting	
1.	Adeyemi, Semiu Babatunde

Financial Reporting	
1.	Okwuosa, Innocent

Performance Management	
1.	Durukwaku, Sylvester

Corporate Strategic Management and **Ethics**	
1.	Adepate, Olutoyin Adeagbo

Audit & Assurance	
1.	Amadi, Nathaniel

Corporate Reporting	
1.	Adeadebayo, Shuaib

Advanced Audit and **Assurance**	
1.	Okere, Onyinye

Strategic Financial Management	
1.	Omolehinwa, Ademola

The Institute also appreciates the services of the following:

STUDY TEXTS REVIEW COMMITTEE

Members	
Haruna Nma Yahaya (Mallam), mni, BSc, MBA, ANIM, FCA	Chairman
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Akinsulire, O. O. (Chief), B.Sc, M.Sc., MBA, FCA	Deputy Chairman
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Anifowose, Isaac, B.Sc., MMP	Manager, Students' Affairs
Evbuomwan, Yewande, B.Sc. (Ed.), M.Ed., ACIS	Asst. Manager, Students' Affairs

Ahmed M. Kumshe, (Prof.), FCA
Registrar/Chief Executive

Professional level

Advanced Taxation

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Tax administration

Contents

1 Tax administration

1.0 Purpose

At the end of this chapter, readers should be able to know:

(a) The systems of administration of tax in Nigeria;
(b) The roles of the three arms of government as they relate to taxation;
(c) Taxes and levies collectible by each tier of government in Nigeria;
(d) The functions of the various organs of tax administration;
(e) The limitations of tax administration in Nigeria;
(f) The challenges of multiplicity of taxes in Nigeria and possible solutions

1.1 Fiscal federalism and the Nigerian tax administration system

1.1.1 Constitutional provisions regarding fiscal federalism in Nigeria

Fiscal federalism is the system of revenue generation and redistribution within a federal system. It concerns the financial and attendant functions and responsibilities of component units within a federal structure.

Nigeria's fiscal federalism is a product of historical, economic, political, geographical, cultural and social factors.

The Constitution of the Federal Republic of Nigeria (CFRN) Cap C.23 LFN 2004(as amended) entrenches the fundamental principles of federalism.

Section 2(1) of the CFRN, provides that "Nigeria is one indivisible sovereign state to be known by the name of the Federal Republic of Nigeria" while section 2(2) further provides that "Nigeria shall be a federation consisting of states and a federal capital territory".

1.1.2 Structure and taxing rights of different levels of government

For tax purposes and in accordance with its constitutional provision, Nigeria is divided into three constituencies - The Federal, State and Local governments.

The Federal Government is responsible for the assessment and collection of taxes due from all taxable corporate bodies, personnel of the Nigerian armed forces and those employed in Nigeria's foreign missions. With the enactment of Federal Capital Territory Internal Revenue Service (FCT-IRS) Act of 2015, the FCT-IRS is responsible for the assessment and collection of taxes due from all taxable individual residents of the Federal Capital Territory, Abuja. Prior to the enactment of FCT – IRS Act of 2015, the Federal Government is responsible for the assessment and collection of taxes due from all taxable individual residents in Federal Capital Territory, Abuja.

Each State government is responsible for the assessment and collection of the taxes due from all taxable persons resident in the state with the exception of personnel of the Nigerian Armed Forces, employees of the Nigeria foreign missions and individual residents of the Federal Capital Territory, Abuja.

The taxing right for each of the three tiers of government is as contained in the Taxes and Levies (Approved List for Collection) Act No 21, 1998(as amended),which is now referred to as Taxes and Levies (Approved List for Collection) Act CapT2 LFN 2004 (as amended).

1.1.3 Taxes and levies collectible by each tier of government

These are as follows:

a) **The federal government**

(i) Companies income tax

(ii) Withholding taxes on companies and non-residents

(iii) Petroleum profits tax

(iv) Value added tax

(v) Tertiary education tax

(vi) Capital gains tax for companies and non-residents

(vii) Stamp duties on companies and non-residents

(viii) Personal income tax in respect of members of Armed forces, Police forces and those employed in Nigeria's foreign missions

Note that with establishment of Federal Capital Territory Internal Revenue Service, vide the FCT Internal Revenue Service Act 2015, the personal income tax of persons resident in Federal Capital Territory, Abuja, is collectible by the Federal Capital Territory Internal Revenue Service.

b) **The state government**

(i) Personal income tax (PAYE and Direct assessment).

(ii) Withholding taxes on individuals as restricted above

(iii) Capital gains tax on individuals as restricted above

(iv) Stamp duties on instruments executed by individuals as restricted above

(v) Pools betting and lotteries, gaming and casino taxes

(vi) Road taxes

(vii) Business premises registration fee

(viii) Development levy

(ix) Naming of street registration fees in the state capital

(x) Right of occupancy fees on land owned by the state government in urban areas of the state

(xi) Market taxes and levies where the state finance is involved

c) **The local government**

(i) Shops and kiosk rates

(ii) Tenement rates

(iii) On and off liquor license fees

(iv) Slaughter slab fees

(v) Marriage, birth and death registration fees

(vi) Naming of street registration fees excluding any street in the state capital

(vii) Right of occupancy fees in rural areas excluding those collected by the federal and state government.

(viii) Market taxes and levies excluding where state finance is involved

(ix) Motor park levies

(x) Domestic animals license fees

(xi) Bicycle, trucks, canoes, wheelbarrow and cart fees, other than mechanically propelled trucks

(xii) Cattle tax payable by cattle farmers only

(xiii) Merriment and road closure levy

(xiv) Radio and Television License (RTV) fees (Other than radio and TV transmitter)

(xv) Vehicle radio license fees (To be imposed by the LG of the state where the vehicle is registered)

(xvi) Wrong parking charges

(xvii) Public convenience, sewage and refuse disposal fees

(xviii) Customary burial ground permit fees

(xix) Religious places establishment permit fees

(xx) Signboard and advertisement permit fees

It is pertinent to note that the Federal Government expanded the taxes and levies which the tiers of government can impose through the Schedule to the Taxes and Levies (Approved List for Collection) Act (Amendment) Order, 2015. In this Order made by the Minister of Finance, several new tax/levy heads, such as infrastructure maintenance/development levy, wharf landing charge/fee, consumption tax, the National Information Technology Development levy, etc were introduced.

However, on May 8, 2020, the Federal High Court sitting in Lagos, delivered judgment in Suit Number: FHC/L/CS/1082/2019 between ***The Registered Trustees of Hotel Owners and Managers Association of Lagos*** (suing for itself and on behalf of all its members) Vs. ***The Attorney-General of the Federation & Others*** and held that the ***Ministerial Order 2015 is unconstitutional, null and void***.

The Court submitted that the Constitution vests the legislature with the power to make laws. The Court further stated that schedules to a law are part and parcel of that law and as such, ***only the legislature can amend schedules to a law***. The implication of this ruling is that all the taxes and levies that were added to those ones in the Taxes and Levies (Approved List for Collection) Act Cap. T2 LFN 2004, via the Ministerial Order 2015, are illegal and cannot be enforced.

1.2 Composition and functions of the various organs of tax administration

Each tier of government has its own tax authority, created by federal laws. The authorities include:

1.2.1 Federal Inland Revenue Service Board (FIRSB)

The administration of taxation on the profits of incorporated companies is vested in the Federal Inland Revenue Service (FIRS) whose management board is known as the Federal Inland Revenue Service Board (FIRSB) (Sections 1-3 FIRS Establishment Act, 2007).

a) **Composition of the FIRSB**

The Federal Inland Revenue Service Board comprises:

(i) The Executive Chairman of the Service who shall be experienced in taxation as Chairman of the Service to be appointed by the President and subject to the confirmation of the Senate;

(ii) Six members with relevant qualifications and expertise who shall be appointed by the President to represent each of the six geo- political zones;

(iii) A representative of the Attorney-General of the Federation;

(iv) The Governor of the Central Bank of Nigeria or his representative;

(v) A representative of the Minister of Finance not below the rank of a Director;

(vi) The Chairman of the Revenue Mobilisation, Allocation and Fiscal Commission or his representative who shall be any of the commissioners representing the 36 states of the Federation;

(vii) The Group Managing Director of the Nigerian National Petroleum Corporation or his representative who shall not be below the rank of a Group Executive Director of the Corporation or its equivalent;

(viii) The Comptroller-General of the Nigerian Customs Service or his representative, not below the rank of Deputy Comptroller- General;

(ix) Registrar-General of the Corporate Affairs Commission or his representative not below the rank of a Director; and

(x) The Chief Executive Officer of the National Planning Commission or his representative not below the rank of a Director.

The members of the Board, other than the Executive Chairman, shall be part-time members. Also, the Chairman and other members of the Board, other than ex-officio members shall each hold office.

- For a term of 4 years renewable once only; and
- On such terms and conditions as may be specified in the letter of appointment.

b) **Powers of FIRSB**

The Board shall:

(i) Provide the general policy guidelines relating to the functions of the Service;

(ii) Manage and superintend over the policies of the Service on matters relating to the administration of the revenue assessment, collection and accounting system under the Act or any enactment or law;

(iii) Review and approve the strategic plans of the Service;

(v) Employ and determine the terms and conditions of service including disciplinary measures of the employees of the Service;

(vi) Stipulate remuneration, allowances, benefits and pensions of staff and employees in consultation with the National Salaries, Income and Wages Commission; and

(vii) Do such other things, which in its opinion, are necessary to ensure the efficient performance of the functions of the Service under the Act

c) **Functions of FIRS**

The Service shall:

(a) Assess persons including companies, enterprises chargeable with tax;

(b) Assess, collect, account and enforce payment of taxes as may be due to the Government or any of its agencies;

(c) Collect, recover and pay to the designated account any tax under provision of the Act or any other enactment or law;

(d) In collaboration with the relevant ministries and agencies, review regimes and promote the application of tax revenues to stimulate economic and development;

(e) In collaboration with the relevant law enforcement agencies, carry out examination and investigation with a view to enforcing compliance with provisions of the Act;

(f) Make, from time to-time, a determination of the extent of financial such other losses by government arising from tax fraud or evasion and s losses (or revenue forgone) arising from tax waivers and other related matters;

(g) Adopt measures to identify, trace, freeze, confiscate or seize proceeds derived from tax fraud or evasion;

(h) Adopt measures which include compliance and regulatory actions, introduction and maintenance of investigative and control techniques on detection and prevention of non-compliance;

(i) Collaborate and facilitate rapid exchange of information with relevant national or international agencies or bodies on tax matters;

(j) Undertake exchange of personnel or other experts with complementary agencies for purposes of comparative experience and capacity building;

(k) Establish and maintain a system for monitoring international dynamics of taxation in order to identify suspicious transactions and the perpetrators and other persons involved;

(l) Provide and maintain access to up to date and adequate data and information on all taxable persons, individuals, corporate bodies or all agencies of government involved in the collection of revenue for the purpose of efficient, effective and correct tax administration and to prevent tax evasion or fraud;

(m) Maintain database, statistics, records and reports on persons, organisations, proceeds, properties, documents or other items or assets relating to tax administration including matters relating to waivers, fraud or evasion;

(n) Undertake and support research on similar measures with a view to stimulating economic development and determine the manifestation, extent, magnitude and effects of tax fraud, evasion and other matters that affect effective tax administration and make recommendations to the government on appropriate intervention and preventive measures;

(o) Collate and continually review all policies of the Federal Government relating to taxation and revenue generation and undertake a systematic and progressive implementation of such policies;

(p) Liaise with the office of the Attorney-General of the Federation, all government security and law enforcement agencies and such other financial supervisory institutions in the enforcement and eradication of tax related offences;

(q) Issue taxpayer identification number to every taxable person in Nigeria in collaboration with States Boards of Internal Revenue and Local Government Councils;

(r) Carry out and sustain rigorous public awareness and enlightenment campaign on the benefits of tax compliance within and outside Nigeria;

(s) Carry out oversight functions over all taxes and levies accruable to the Government of the federation and as it may be required, query, subpoena, sanction and reward any activities pertaining to the assessment, collection of and accounting for revenues accruable to the Federation; and

(t) Carry out such other activities as are necessary or expedient for the full discharge of all or any of the functions under the Act

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(c) **Duties of the Secretary to the FIRSB (Section 12)**

There shall be a Secretary to the Board who shall be appointed by the Board within the FIRS whose duties are to:

(i) Issue notices of meetings of the Board;

(ii) Keep records of the proceedings of the Board; and

(iii) Carry out such duties as the Executive Chairman or the Board may, from time to time, direct.

In order to assist the FIRS in the performance of its duties, provision is made in Section 9 for the setting up of a committee of the Board, to be known as "The Technical Committee".

(d) **Composition of the Technical Committee**

The Technical Committee shall consist of:

(i) The Executive Chairman of FIRS as Chairman of the committee;

(ii) All Directors and Heads of departments of the FIRS;

(iii) The Legal Adviser to FIRS; and

(iv) Secretary to FIRSB.

The Technical Committee may co-opt from the Service, such staff as it may deem necessary, for the effective performance of its functions under the Act.

(e) **Functions of the Technical Committee, Federal Inland Revenue Service Board**

The functions are:

(i) To consider all tax matters that require professional and technical expertise and make recommendations to the Board;

(ii) To advise the Board on any aspect of the functions and powers of the FIRS; and

(iii) To attend to such other matters as may from time to time be referred to it by the Board.

1.2.2 Joint Tax Board (JTB)

Section 86 of the Personal Income Tax Act Cap P8 LFN 2004 (as amended) established the Joint Tax Board (JTB).

(a) **Composition**

The JTB comprises:

(a) The Chairman of the Federal Inland Revenue Service Board appointed pursuant to section 11 of the Federal Inland Revenue Service (Establishment) Act 2007 who shall be the Chairman of the JTB;

One member from each State who shall be the Chairman of the State Internal Revenue Service whose nomination shall be evidenced by writing delivered to the Secretary to the Board by the Governor.

(b) The JTB shall appoint an officer who is experienced in income tax matters to be the Secretary to the Board, and may, in accordance with existing law, appoint such other staff, from time to time, including secondment or transfer from public service in Nigeria; and

(c) The Legal Adviser of the FIRS acts as the legal adviser to the JTB and shall be in attendance at meetings and serve as adviser to the Board.

(b) **Quorum**

Seven members or their representatives shall constitute a quorum {Section 86 (6)}.

(c) **Functions of the JTB**

The Board shall:

(a) Exercise the powers or duties conferred on it by the Personal Income Tax Act (PITA) and other Acts;

(b) Advise the Federal Government, on request, in respect of double taxation arrangement with any other country;

(c) Advise the Federal Government, on request, in respect of rates of capital allowances and other taxation matters, having effect throughout Nigeria in respect of any proposed amendment to PITA;

(d) Promote uniformity, both in the application of PITA and in the incidence of tax on individuals throughout Nigeria; and

(e) Impose its decisions on matters of procedure and interpretation of PITA, on any State, for purposes of conforming to agreed procedures or interpretations.

1.2.3 State Board of Internal Revenue (SBIR)

Section 87 of PITA, 2004 and PIT (Amendment) Act, 2011, established the State Board of Internal Revenue whose operational arm is known as The State Internal Revenue Service (SIRS).

(a) Composition

(i) The Executive Chairman of the State Service who shall be a person experienced in taxation and a member of a relevant recognised professional body, appointed by the State Governor, subject to confirmation by the State House of Assembly;

(ii) The Directors from within or outside the State Service;

(iii) A Director from the State Ministry of Finance;

(iv) A Legal Adviser to the State Service;

(v) Three other persons appointed by the State Governor on their personal merit, one each representing a Senatorial District in the State; and

(vi) The Secretary of the State Service, who shall be an ex-officio member.

Note that any five members of the State Board of Internal Revenue of whom one shall be the Chairman or a Director, shall constitute a quorum.

(b) Functions and Powers

The State Board shall be responsible for:

(i) The assessment and collection of Pay As You Earn (PAYE) and other personal income tax;

(ii) Ensuring the effectiveness and optimum collection of all taxes and penalties due to government;

(iii) Doing all such things as may be deemed necessary and expedient for the assessment and collection of and account for all amounts so collected in a manner to be prescribed by the Commissioner;

(iv) Making recommendation, where appropriate, to the JTB on tax policy, tax reforms, tax legislations, tax treaties and exemptions as may be required from time to time;

(vi) Generally controlling the management of the State Service on matters of policy, subject to the provision of the law setting up the State Service; and

(vii) Appointing, promoting, transferring and imposing discipline on employees of the State Service.

Note that an amount of not less than 5 percent of revenue collected as may be approved by a State House of Assembly shall be retained by the State Board of Internal Revenue to defray cost of collection and administration.

(c) Technical Committee of SBIR

Section 89 established the Technical Committee of the State Board of Internal Revenue.

(i) **Composition**

The Committee comprises:

- Executive Chairman of the State Board as Chairman;
- The Directors within the State Service;
- The Legal Adviser to the State Service; and
- The Secretary of the State Service.

(ii) **Functions**

These are:

- Consider all matters that require professional and technical expertise and make recommendations to the Board;
- Advise the Board on its power and duties; and
- Attend to such other matters that may from time to time be referred to it.

1.2.4 Joint State Revenue Committee

(a) **Composition**

According to the Act, each state of the federation should have a Joint State Revenue Committee, comprising:

(i) The Chairman of the State Board of Internal Revenue who acts as Chairman of the Committee;

(ii) The Chairman of the Local Government Revenue Committee;

(iii) A Representative of the Bureau of Local Government Affairs not below the rank of a Director

(iv) A Representative of the Revenue Mobilisation, Allocation and Fiscal Commission, as an observer;

(v) State Sector Commander of the Federal Road Safety Commission (FRSC) as an observer;

(vi) Legal Adviser of the State Internal Revenue Service; and

(vii) Secretary to the Committee who shall be a staff of the State Internal Revenue Service.

(b) **Functions of the Joint State Revenue Committee**

The functions of the Committee shall be to:

(i) Implement decisions of the Joint Tax Board ;

(ii) Advise the Joint Tax Board and the State and Local Governments on revenue matters;

(iii) Harmonise Tax Administration in the State;

(iv) Enlighten members of the public generally on State and Local Government revenue matters; and

(v) Execute such other functions as may from time to time be assigned by the Joint Tax Board.

1.2.5 The Local Government Revenue Committee (LGRC)

The LGRC operates in each local government of a state.

(a) **Composition**

The Revenue Committee shall comprise:

(i) The Supervisor for Finance as Chairman;

(ii) Three Local Government Councilors as members; and

(iii) Two other persons experienced in revenue matters to be nominated by the Chairman of the Local Governments on their personal merits.

(b) **Functions**

The Revenue Committee shall be responsible for:

(i) The assessment and collection of all taxes, fines and rates under its jurisdiction and shall account for all amounts so collected in a manner to be prescribed by the Chairman of a Local Government; and

(ii) The day-to-day administration of the department which forms its operational arm. The Committee shall be autonomous of a Local Government Treasury Department.

1.3 Limitations of tax administration

The following are some of the constraints to effective tax administration in Nigeria:

(a) Poor public enlightenment;
(b) Inadequate funding of tax authorities;
(c) Dearth of qualified and / or experienced tax officials at the state and local government tiers of government;
(d) Tax evasion;
(e) Improper use of tax consultants;
(f) Lack of will power on the part of personnel of tax authorities (administrative
(g) ineffectiveness);
(h) Loop holes in the relevant laws; and
(i) Poor governance.

1.4 Challenges of multiplicity of taxes and possible solutions

1.4.1 Definition of tax

According to the National Tax Policy [NTP] document, tax is defined as "any compulsory payment to government imposed by law without direct benefit or return of value or a service whether it is called tax or not".

1.4.2 Multiple taxation

Multiple taxation occurs "where the tax, fee or rate is levied on the same person in respect of the same liability by more than one taxing authority (State or Local Government Council)."

In addition to the above, multiple taxation shall be deemed to occur: when there is unlawful and compulsory payments to the government without legal backing, where a taxpayer is faced with demands from the state or local government for the same or similar taxes e.g. Value added tax (VAT) and sales/consumption tax, where the government imposes more than one tax on the same tax base e.g. Companies income tax, tertiary education tax and technology levy on corporate taxpayers.

1.4.3 Causes of multiplicity of taxes

As stated above the statutory approved list for collection of taxes, in accordance with the Taxes and Levies (Approved List for Collection) Act Cap T2 LFN 2004 (as amended) states that there are 39 taxes in Nigeria. This number is rather alarming. Some of the causes of multiplicity of taxes are as follows:

(a) It would appear that the listing of 20 items in "Taxes and Levies Act" in favour the local governments is one of the factors that motivated them into the inordinate drive for revenue through those items;

(b) Administratively, most of the State Boards of Internal Revenue are plagued with various problems including poor funding, lack of infrastructure, poor remuneration and lack of motivated skilled personnel;

(c) Some of the state's governments deliberately deny their local governments the revenue due to them and in some cases have even usurped the taxes assigned to the local governments. Consequently, the local governments, as a way of survival desperately and aggressively focus on anything that will generate revenue for them. For example, a development levy of just N100 is being collected by the states;

(d) All the tiers of government usually fail to adequately fund their departments and agencies. These developments make them to embark on aggressive revenue drive even illegally in the name of increasing their internally generated revenue; and

(e) Lack of tax information and data.

1.5 Impact of multiplicity of taxes on tax compliance and revenue yield

(a) **Problems arising from multiplicity of taxes**

Some of the ways by which multiplicity of taxes impacts on tax compliance and revenue yield include:

(i) Multiplicity of taxes comes with a lot of uncertainties in the investment environment. The investors are not sure of the extent to which their incomes would be taxed. This has basically led to large corporate entities moving their operations out of some states or from Nigeria to neighboring countries on account of multiplicity of taxes and other relevant reasons; and

(ii) Tax yield is very low as a result of numerous taxes that brings in little but with high cost of administration. Tax yield is the revenue that accrues to government after taking account of the cost of administration.

(b) **Possible solutions**

These include:

(i) Streamlining the number of taxes in Nigeria in view of the low yields of many of the taxes. This will involve the review of current statutory provisions in Nigeria; and

(ii) Accepting the recommendations of the 2003 Study Group which state that all the existing taxes in Nigeria should be abolished and replaced by only two taxes imposed at the rate of 10 per cent as follows: income tax (covering both individuals and corporate entities) ;and expenditure tax (covering all expenditures) The features of the proposed taxes are as follows:

- Both taxes will be internal and there will be no external taxes of whatever description, for example, import duties, export duties, etc. non-tax measures will be relied upon for anti-dumping purposes;
- The liability for income tax will be determined by residence of taxpayers while that of the expenditure tax will be determined by location of spending;
- Both taxes will concentrate on the formal sector of the economy;
- Each State will have a tax authority while there will be a federal tax authority to take care of the Federal Capital Territory (FCT);
- Both taxes will be administered in each state by the state tax authority while the federal tax authority will administer both at the FCT; and
- Local government will have no taxing power in the new tax system.

The new tax system is predicated in the following arguments:

(i) Taxes of all description are ultimately on either income or expenditure. The argument is that it makes for simplicity to have two broad-based taxes instead of having a bewildering number of mushroom taxes that produce little or nothing;

(ii) Broad-based income and expenditure taxes will be more difficult to evade;

(iii) While some of the existing taxes are not significant sources of revenue they continue to contribute to administrative cost;

(iv) Complex tax system may benefit tax consultants but it is a drain to taxpayers and economy;

(v) It will remove the problem of multiplicity of taxes at the local government level;

(vi) Allowances, exemptions, concessions, waivers, tax holidays and other such preferential devices not only make taxes unduly complex, they also create enormous avenues for abuse, corruption, tax avoidance, avoidable increase in the cost of administration; and

(vii) The exemption of informal sector is justified on the basis that the operators are atomistic in scale and keep no record. Their exemption does not mean that they will escape taxation altogether as they will pay expenditure tax when they enter the formal sector to make purchases and buy at prices which already reflect expenditure tax. It was said that the proposed new tax system has a better revenue potential than the current system.

The Constitution should be amended to accommodate the new tax system. Also, a technical Committee was recommended to be set up to work out the details of the new system. Perhaps due to the radical nature of the proposal, its effect on entrenched interests and the general reluctance to change, the above recommendations were rejected by the federal government.

1.6 Chapter review

This chapter examines the dynamics of fiscal federalism, the Nigerian tax administration system and the composition/functions of the various organs of tax administration.

Readers must have learnt about the problems, impacts and possible solutions relating to multiplicity of taxes. In addition, issues relating to fiscal policy and its components must have become handy to the readers.

1.7 Worked examples

1.7.1 Open-ended questions

1. i. Discuss the functions of any THREE organs of tax administration in Nigeria.

   ii. What are the problems of tax administration in Nigeria?

2. (a) Ms. Lilian Abu is a Nigerian born with a British mother. She grew up and schooled in the UK after which she took up a job with Her Majesty Revenue and Customs (HMRC) as a revenue officer. She has been selected to join a team of international reviewers visiting Nigeria in the coming months under a project funded by the World Bank.

   Lilian has contacted you as part of her initial research to understand the tax system in Nigeria ahead of her visit.

   Required:

   i. Discuss the structure of the tax administration system in Nigeria.

   ii. Discuss the functions of any TWO organs of tax administration in Nigeria.

   (a) Lilian informed you that based on her Google searches, she had seen a lot of concerns being expressed by Nigerian taxpayers over multiple taxation.

   Required:

   Explain the concerns by Nigerian taxpayers over multiple taxation and outline the causes and possible solutions of multiple taxation in Nigeria.

3. State the functions of the Joint Tax Board (JTB).

1.7.2 Suggested Solutions to Worked examples

(1) **Functions of Federal Inland Revenue Service Board (FIRSB) are:**

a. Provide the general policy guidelines relating to the functions of the Service;
b. Manage and superintend over the policies of the Service on matters relating to the administration of the revenue assessment, collection and accounting system under this Act or any enactment or law;
c. Review and approve the strategic plans of the Service;
d. Employ and determine the terms and conditions of service including disciplinary measures of the employees of the Service;
e. Stipulate remuneration, allowances, benefits and pensions of staff and employees in consultation with the National Salaries, Income and Wages Commission; and do such other things, which in its opinion, are necessary to ensure the efficient performance of the

functions of the Service under the Act.

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Functions of the Joint Tax Board (JTB) are:

a. Exercise the powers or duties conferred on it by the PITA and other Acts;

b. Advise the Federal Government, on request, in respect of double taxation arrangement with any other country;

c. Advise the Federal Government, on request, in respect of rates of capital allowances and other taxation matters, having effect throughout Nigeria in respect of any proposed amendment to PITA;

d. Promote uniformity, both in the application of PITA and in the incidence of tax on individuals throughout Nigeria; and

e. Impose its decisions on matters of procedure and interpretation of PITA, on any State, for purposes of conforming to agreed procedures or interpretations.

Functions of State Board of Internal Revenue (SBIR) are:

a. The assessment and collection of Pay As You Earn (PAYE) and other personal income tax;
b. Ensuring the effectiveness and optimum collection of all taxes and penalties due to government;
c. Doing all such things as may be deemed necessary and expedient for the assessment and collection of and account for all amounts so collected in a manner to be prescribed by the Commissioner;
d. Making recommendation, where appropriate, to the JTB on tax policy, tax reforms, tax legislations, tax treaties and exemptions as may be required from time to time;
e. Generally controlling the management of the State Service on matters of policy, subject to the provision of the law setting up the State Service; and
f. Appointing, promoting, transferring and imposing discipline on employees of the State Service.

ii) 1 The following are some of the constraints/problems to effective tax administration in Nigeria:

(a) Poor public enlightenment;
(b) Inadequate funding of tax authorities;
(c) Dearth of qualified and / or experienced tax officials at the state and local government tiers of government;
(d) Tax evasion;
(e) Improper use of tax consultants;
(f) Lack of will power on the part of personnel of tax authorities (administrative ineffectiveness);
(g) Loop holes in the relevant laws; and
(h) Poor governance.

2.a (i) **Structure and taxing rights of different levels of government**

For tax purposes and in accordance with its constitutional provision, the three tiers of government responsible for taxes collection in Nigeria are the Federal, State and Local Governments. The taxing right for each of the three tiers of government is contained in the Taxes and Levies (Approved List for collection) Act Cap T2 LFN 2004 (as amended).

The Federal Government is responsible for the administration and collection of taxes due from all taxable corporate bodies, personnel of the Nigerian Armed Forces and those employed in Nigeria's foreign missions through the Federal Inland Revenue Service (FIRS).

Examples of taxes collected by Federal Government are: Companies income tax, Petroleum profits tax, Value added tax, Personal income tax from members of armed forces personnel, police force, Capital gains tax for companies and non-residents, withholding tax from companies, stamp duties.

Note that with the enactment of the FCT-IRS Act 2015, taxes payable by residents of the FCT are now collectible by the FCT-IRS.

Each state government is responsible for administration, assessment and collection of the taxes due from all taxable persons resident in the state with the exception of the Nigerian Armed Forces and employees of the Nigeria foreign missions through each State's Internal Revenue Service (SIRS).

Examples of taxes collected by State Government are Personal income tax, withholding tax from individuals and unincorporated entities, Capital gains tax for individuals and unincorporated entities, stamp duties, road taxes, pools betting and lotteries, gaming and casino taxes, development levy, etc.

Local government is responsible for collecting levies such as shop and kiosk rates, tenement rates, on and off liquor licenses fees, slaughter slab fees, marriage, birth and death registration fees, motor park levies, road closure levy, etc.

Local government taxes/levies are collected by the Local Government Revenue Committee in each state.

(a) (ii) **Functions of organs of tax administration in Nigeria are as follows:**

Federal Inland Revenue Service Board (FIRSB)

The FIRSB shall be responsible to:

- Provide the general policy guidelines relating to the functions of the Service;
- Manage and superintend the policies of the Service, on matters relating to the administration of the revenue assessment, collection and accounting system under this Act or any enactment or law;
- Review and approve the strategic plans of the Service;
- Employ and determine the terms and conditions of service including disciplinary measures of the employees of the Service;

- Stipulate remuneration, allowances, benefits and pensions of staff and employees in consultation with the National Salaries, Income and Wages Commission; and
- Do such other things, which in its opinion, are necessary to ensure the efficient performance of the functions of the Service under the Act.

State Board of Internal Revenue Service (SBIRS)

The SBIRS shall be responsible for:

- Ensuring the effectiveness and optimum collection of all taxes and penalties due to the Government under the relevant laws;
- Doing all such things as may be deemed necessary and expedient, for the assessment and collection of the tax and shall account for all sums so collected, in a manner to be prescribed by the Commissioner;
- Making recommendations, where appropriate, to the JTB on tax policy, tax reform, tax legislation, tax treaties and exemptions as may be required from time to time
- Generally controlling the management of the State Service on matters of policy, subject to the provisions of the law setting up the State Internal Revenue Service; and
- Appointing, promoting, transferring and imposing discipline on employees of the State Internal Revenue Service.

Local Government Revenue Committee (LGRC)

The LGRC shall be:

- Responsible for the assessment and collection of all taxes, fines and rates, under its jurisdiction and shall account for all amounts so collected, in a manner to be prescribed by the Chairman of the Local Government;
- Autonomous of the local Government Treasury department and shall be responsible for the day-to-day administration of the Department, which forms its operational arm;
- Responsible for tax payer education; and
- Responsible for collection of data and information to develop and reform tax policies legislation and administration.

(b) Multiple taxation: Multiple taxation is a tax regime under which various and similar types of taxes are imposed on taxpayers by different tiers of government. For instance, while the Federal Government imposed the Value added tax on consumption and made it applicable throughout the Federation, some notably, Lagos State, introduced the sales tax based on the same principle as the former and made it applicable in Lagos State.

i) Causes of multiple taxation in Nigeria: The possible causes of multiple taxation in Nigeria are:

- The number of taxes which local government has constitutional right to collect;
- Lack of funding, particularly, for most States may result to multiple taxation where the Board attempts to source for fund through levying of tax notwithstanding whether such tax had already been levied either by the Federal or Local Governments;
- Some of the state governments deliberately deny their local governments the revenue due to them, consequently the local government as a way of survival desperately and aggressively focus on anything that will generate revenue to them;
- Lack of tax education and awareness;
- Inability of all the tiers of government to adequately fund their departments and agencies;
- Multiplicity of revenue agencies;
- Overlapping taxing rights as contained in the Constitution and the taxed and levies (approved list

for collection); and

- Manual tax administration system and unauthodox tax collection mechanism.

ii) Possible solutions to multiple taxation in Nigeria include:
- Streamlining the number of taxes in Nigeria in view of the low yields of many of the taxes, This will involve the review of current statutory provisions in Nigeria;
- Reviewing all the existing taxes in Nigeria and harmonise where necessary, as recommended by various study groups;
- Reviewing of the Constitution to address the overlap in taxing rights and limit the number of taxes that can be imposed by different levels;
- Abolishing unauthodox method of tax collection and implement technology for tax administration; and
- Limiting the number of revenue agencies.

3. **Functions of the JTB**

The Board shall:

(a) Exercise the powers or duties conferred on it by the Personal Income Tax Act (PITA) and other Acts;

(b) Advise the Federal Government, on request, in respect of double taxation arrangement with any other country;

(c) Advise the Federal Government, on request, in respect of rates of capital allowances and other taxation matters, having effect throughout Nigeria in respect of any proposed amendment to PITA;

(d) Promote uniformity, both in the application of PITA and in the incidence of tax on individuals throughout Nigeria; and

(e) Impose its decisions on matters of procedure and interpretation of PITA, on any State, for purposes of conforming to agreed procedures or interpretations.

2

Tax dispute resolution in Nigeria

Content

2 Tax dispute resolution in Nigeria

2.0 Purpose

After studying this chapter, readers should be able to:

(a) Know the composition and jurisdiction of Tax Appeal Tribunal;

(b) Understand what constitutes an appeal;

(c) Know the procedure for raising objections to tax assessments;

(d) Know the procedure for the hearing of appeals;

(e) Know the procedure to be followed for further appeals to the High Court, Court of Appeal and Supreme Court; and

(f) Know taxpayers rights in a dispute.

2.1 Objection and appeal procedures

(a) Where a taxpayer receives a notice of assessment, he either agrees with it or he is aggrieved. Where he agrees with the assessment, the position of the law is that the tax must be remitted within the statutory time limit of sixty days from the date of receipt of the assessment.

(b) Where he is aggrieved however, he is expected to raise a **notice of objection**. The notice of objection must be valid for it to have any effect.

For a notice of objection to be valid, such a notice:

(i) Must have been made in writing;

(ii) Must have been made within 30 days of the receipt of the notice of assessment; and

(iii) Must contain the grounds of objection.

(c) Upon the receipt of the valid notice of objection, the relevant tax authority will examine the grounds of objection to determine ts validity. Where the grounds are found to be valid, the tax computation would be reviewed and a revised or amended assessment raised. Payment would be based on the revised amendment.

(d) Where the relevant tax authority believes that there is no merit in the notice of objection, then a **notice of refusal to amend** (NORA) would be sent to the taxpayer.

(e) The taxpayer, if aggrieved by the notice of refusal to amend, should file a **notice of appeal** to the Tax Appeal Tribunal within 30 days of the receipt of the notice of refusal to amend.

Information required in a **valid notice of appeal**

For a notice of appeal to be valid, the following information must be included:

(i) The tax file number;
(ii) The relevant year of assessment;
(iii) The date the notice of refusal to amend was received;
(iv) The assessable profit for the year of assessment being disputed;
(v) The taxable profit being disputed;
(vi) The amount of tax payable disputed; and
(vii) The grounds of appeal. Note that the grounds of appeal may not be different from the grounds of objection.

2.2 Establishment of a Tax Appeal Tribunal

The Tax Appeal Tribunal was established by section 59(1) of the Federal Inland Revenue Service (Establishment) Act 2007, as provided for in the Fifth schedule to the Act. The Tax Appeal Tribunal (TAT) is an administrative body established by the Federal Inland Revenue Service Establishment Act to hear and resolve tax disputes arising from all federal tax legislation. These include, the Companies Income Tax Act, Personal Income Tax Act, Petroleum Profits Tax Act, Value Added Tax Act, Capital Gains Tax Act, Stamp Duties Act, Tax and Levies (Approved List for Collection) Act, all regulations or rules issued in terms of these legislations and any other laws subsequently passed by the National Assembly.

The tribunal is the first forum for aggrieved persons (taxpayers or tax authorities) to litigate before approaching the High Court.

The tribunal operates in eight (8) zones across the federation, with a tribunal in each of the six (6) geopolitical zones (Ibadan, Benin, Enugu, Kaduna, Jos and Bauchi) as well as Lagos and Abuja.

2.2.1 Power of the Minister

According to the Act, the Minister of Finance may by notice in the federal gazette specify the number of zones, matters and places in relation to which the tribunal may exercise jurisdiction.

2.2.2 Composition of the Tribunal

The Tribunal shall consist of five members (hereinafter referred to as “Tax Appeal Commissioners”) to be appointed by the Minister of Finance.

Appointment and meetings of the Tribunal

(a) A Chairman for each zone shall be a legal practitioner who has been so qualified to practice for a period of not less than 15 years with cognate experience in tax legislation and tax matters.
(b) A Chairman shall preside at every sitting of the Tribunal and in his absence, the members shall appoint one of them as the Chairman.

(c) The quorum at any sitting of the Tribunal shall be three (3) members.

The Tribunal may conduct its hearing remotely via virtual means using such technology or application as may be necessary to ensure fair hearing – paragraph 20 of the Fifth Schedule of CITA was amended by section 57 of the Finance Act, 2020.

During its meetings, the Tribunal shall have the power to conduct its proceedings in a manner it deems fit to ensure speedy dispensation of justice.

The hearing of an appeal shall be commenced by the appellant presenting documents and statements which he intends to rely upon as well as any witnesses he desires to call.

The respondent or his representative may in like manner present any document or statement he intends to rely upon as well as any witnesses he desires to call.

At the hearing of an appeal, the Tribunal shall admit all relevant evidence, oral or documentary, adduced by the appellant or the respondent or any person appearing on their behalf.

(1) The oral examination of a witness during his evidence in chief shall be limited to confirming his written deposition and tendering in evidence all documents or other exhibits referred to in his deposition.

(2) Thereafter the other party may cross-examine the witness who may then be re-examined.

Where the Tribunal deems it necessary, it may call upon or, as the case may be, permit any party to produce any additional document or call additional witnesses or file any affidavit to enable it to issue proper directions or orders.

(1) Where the Tribunal, on application of any party, directs that any person shall be summoned to give evidence, or tender any document, the Tribunal may order the deposit of such amount of money before the issue of a summons, as in Form TAT 6 in the First Schedule to the Rules, as will cover the expenses of such person in so attending.

(2) Where a witness does not appear to a summons, the Tribunal upon proof of service of the summons, a note of which shall be made on the record book, may issue a warrant as in Form TAT 7 in the First Schedule to the Rules to bring such witness before the Tribunal at such time as may be convenient.

Qualification for appointment as a Tax Appeal Commissioner

A person shall not be qualified for appointment as a Tax Appeal Commissioner unless he is knowledgeable in the laws, regulations, norms, practices and operations of taxation in Nigeria as well as persons that have shown capacity in the management of trade or business or a retired public servant in tax administration.

Term of Office of a Tax Appeal Commissioner

A Tax Appeal Commissioner shall hold office for a term of three (3) years, renewable for another term of three years only and no more, from the date on which he assumes his office or until he attains the age of 70 years, whichever is earlier.

Resignation and Removal of a Tax Appeal Commissioner

A Tax Appeal Commissioner may by notice in writing under his hand addressed to the Minister resign his office: Provided that the Tax Appeal Commissioner shall, unless he is permitted by the Minister to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor assumes his office or until the expiry of his term of office, whichever is earlier.

A Tax Appeal Commissioner may be removed from office by the Minister on the grounds of gross misconduct or incapacity after due inquiry has been made and the Tax Appeal Commissioner concerned has been informed of the reasons for his removal and given an opportunity of being heard in respect of the reasons.

Salary, allowances and conditions of Service of Tax Appeal Commissioner

The salary and allowances payable to and the terms and conditions of service of the Tax Appeal Commissioners shall be determined by the Revenue Mobilisation Allowance and Fiscal Commission and shall be prescribed in their letters of appointment: Provided that neither the salary and allowances nor the other terms and conditions of service of a Tax Appeal Commissioner shall be varied to his disadvantage after appointment.

Filling up of Vacancies of Tax Appeal Commissioner

If for any reason, other than temporary absence, any vacancy occurs in the office of a Tax Appeal Commissioner, then the Minister shall appoint another person in accordance with the provisions of the Act to fill the vacancy.

2.2.3 Constitution of a Tribunal

The question as to the validity of the appointment of any person as a Tax Appeal Commissioner shall not be the cause of any litigation in any court or tribunal and no act or proceedings before the Tribunal shall be called into question in any manner on the ground merely of any defect in the constitution of the Tribunal.

2.2.4 Appointment of Secretary to the Tribunal

(a) The Minister shall appoint for each place or zone where the Tribunal is to exercise jurisdiction a Secretary who shall:

- (i) Subject to the general control of the Tax Appeal Commissioners, be responsible for keeping records of the proceedings of the Tribunal;
- (ii) Be the head of the secretariat and responsible for the day-to- day administration; and
- (iii) Be responsible for the direction and control of all other employees of the Tribunal.

(b) The official address of the Secretary appointed for each zone shall be published in the federal gazette.

2.2.5 Appointment of other staff of the Tribunal

(a) The Minister shall appoint such other employees as he may deem necessary for the efficient performance of the functions of the Tribunal and the remuneration of persons so employed shall be determined by the National Salaries and Wages Commission.

(b) The employment in the tribunal shall be subject to the provisions of the Pension Reform Act and, accordingly, officers and employees of the Service shall be entitled to pensions and other retirement benefits as are prescribed under the Pension Reform Act.

2.3 Jurisdiction of the Tribunal

(a) The Tribunal shall have power to adjudicate on disputes, and controversies arising from the following tax laws (hereinafter referred to as "The Tax Laws").

(i) Companies Income Tax Act CAP C21 LFN 2004 (as amended)

(ii) Personal Income Tax Act CAP P8 LFN 2004 (as amended)

(iii) Petroleum Profits Tax Act CAP P13 LFN 2004 (as amended)

(iv) Value Added Tax Act CAP V1 LFN 2004 (as amended)

(v) Capital Gains Tax Act CAP S8 LFN 2004; and

(vi) Any other law contained in or specified in the First Schedule to the Act or other laws made or to be made from time to time by the National Assembly.

(b) The Tribunal shall apply such provisions of the tax laws referred to above as may be applicable in the determination or resolution of any dispute or controversy before it.

2.4 Criminal prosecution

Where in the course of its adjudication, the Tribunal discovers evidence of possible criminality, the tribunal shall be obliged to pass such information to the appropriate criminal prosecuting authorities, such as the office of the Attorney-General of the Federation or the Attorney-General of any State of the Federation or any relevant law enforcement agency.

2.5 Appeals to the Tribunal

2.5.1 Notice of appeal

A notice of appeal against an assessment shall specify the following particulars:

(a) The official number of the assessment, the date and the year for which it was made;

(b) The amount of total profits on which the tax was charged;

(c) The amount of the tax charged;

(d) The date of service of notice of refusal by the Revenue Service to amend the assessment;

(e) The precise grounds of appeal against the assessment. These must be the same as the grounds stated in the notice of objection to the Revenue Service; and

(f) Address for service of any notice, correspondence or other documents to be given to the appellant by the Secretary to the Appeal Commissioners.

All notices, documents or correspondence to be given to the Appeal Commissioners shall be addressed to the Secretary to the Appeal Commissioners, in writing, before the hearing of the appeal.

A company may discontinue any appeal by it, on giving notice, in writing, to the Secretary to the

Appeal Commissioners at any time before the hearing of such appeal.

Notwithstanding that a company has given notice of appeal against an assessment, the Revenue Service may revise the assessment in agreement with the company. The Revenue Service shall give notice of such agreement in writing to the Secretary to the Appeal Commissioners, at any time before the hearing of the appeal and such appeal shall be discontinued.

2.5.2 Notice of refusal to amend

When a notice of refusal to amend has been received by any company, the company, if it desires, can appeal against the assessment upon giving notice (notice of appeal) in writing to the Secretary of the Tax Appeal Tribunal, within thirty days from the date of service of the notice of refusal. A late appeal may be accepted upon an application being made to the Tax Appeal Tribunal, if there is reasonable excuse for the delay, for example, postal delays.

2.5.3 Appeals from decisions of the Service (FIRS)

(a) A person aggrieved by an assessment or demand notice made upon him by the Service or aggrieved by any action or decision of the Service under the provisions of the tax laws referred to in paragraph 2.3 (a) above, may appeal against such decision or assessment or demand notice within 30 days of the service of notice(s) of assessments.

(b) An appeal under this schedule shall be filed within a period of 30 days from the date on which a copy of the order or decision which is being appealed against is made, or deemed to have been made by the Service and it shall be in such form and be accompanied by such fee as may be prescribed provided that the tribunal may entertain an appeal after the expiry of the said period of 30 days, if it is satisfied that there was sufficient cause for the delay.

(c) Where a notice of appeal is not given by the appellant as required under (a) above, within the period specified, the assessment or demand notices shall become final and conclusive and the Service may charge interests and penalties in addition to recovering the outstanding tax liabilities which remain unpaid from any person through proceedings at the Tribunal.

2.5.4 Appeals by the Service

Where the Service is aggrieved by the non-compliance by a person in respect of any provision of the tax laws, it may appeal to the tribunal where the person is resident giving notice in writing through the Secretary to the appropriate zone of the tribunal.

2.5.5 Procedure before Tax Appeal Tribunal

(a) As often as may be necessary, Tax Appeal Commissioners shall meet to hear appeals in the jurisdiction or zone assigned to that Tribunal.

(b) Where a Tax Appeal Commissioner has a direct or indirect financial interest in any appeal pending before the Tribunal or where the taxpayer is or was a client of that Tax Appeal Commissioner in his professional capacity, he shall declare such interest to the other Tax Appeal Commissioners and refrain from sitting in any meeting for the hearing of that appeal.

(c) The Secretary to the Tribunal shall give seven clear days notice to the Service and to the appellant of the date and place fixed for the hearing of each

Appeal, except in respect of any adjourned hearing for which the Tax Appeal Commissioners have fixed a date at their previous hearing.

(d) All notices, documents, other than decisions of the Tribunal, may be signified under the hand of the Secretary.

(e) All appeals before the Tax Appeal Commissioners shall be held in public.

(f) The onus of proving that the assessment complained of is excessive shall be on the appellant.

(g) At the hearing of any appeal if the representative of the Service proves to the satisfaction of the Tribunal hearing the appeal in the first instance that:

(i) the appellant has for the year of assessment concerned, failed to prepare and deliver to the Service returns required to be furnished under the relevant provisions of the tax laws mentioned in 2.3 (a) above.

(ii) the appeal is frivolous or vexatious or is an abuse of the appeal process; or

(iii) It is expedient to require the appellant to pay an amount as security for prosecuting the appeal, the Tribunal may adjourn the hearing of the appeal to any subsequent day and order the appellant to deposit with the Service, before the day of the adjourned hearing, an amount, on account of the tax charged by the assessment under appeal, equal to the tax charged upon the appellant for the preceding year of assessment or one half of the tax charged by the assessment, under appeal, whichever is the lesser plus a sum equal to ten percent of the said deposit, and if the appellant fails to comply with the order, the assessment against which he has appealed shall be confirmed and the appellant shall have no further right of appeal with respect to that assessment.

(h) The Tribunal may, after giving the parties an opportunity of being heard, confirm, reduce, increase or annul the assessment or make any such order as it deems fit.

(i) Every decision of the Tribunal shall be recorded in writing by the Chairman and subject to the provisions of paragraph 16, a certified copy of such decision shall be supplied to the appellant or the Service by the Secretary, upon a request made within 30 days of such decision.

(j) Where upon the hearing of an appeal:

(i) No accounts, books or records relating to profits were produced by or on behalf of the appellant;

(ii) Such accounts, books or records were so produced but rejected by the tribunal on the ground that it had been shown to its satisfaction that they were incomplete or unsatisfactory;

(iii) The appellant or his representative, at the hearing of the appeal, has neglected or refused to comply with a notice delivered or sent to him by the Secretary to the Tribunal, without showing any reasonable cause; or

(iv) The appellant or any person employed, whether confidentially or otherwise, by the appellant or his agent (other than his legal practitioner or accountant acting for him in connection with his ability to tax has refused to answer any question put to him by the Tribunal, without showing any reasonable cause, the Chairman of the Tribunal shall record particulars of the same in his written decision.

2.5.6 Procedure following decision of the Tribunal

(a) Notice of the amount of the tax chargeable under the assessment as determined by the tribunal shall be served by the Service upon the taxpayer or upon the person in whose name such taxpayer is chargeable.

(b) An award or judgement of the Tribunal shall be enforced as if it were a judgement of the Federal high Court upon registration of a copy of such award or judgment with the Chief Registrar of the Federal high Court by the party seeking to enforce the award or judgement.

(c) Notwithstanding that an appeal is pending, tax shall be paid in accordance with the decision of the Tribunal within one month of notification of the amount of the tax payable in pursuance of subparagraph (a) of this paragraph.

2.6 Appeal to the Federal High Court

(i) Any person dissatisfied with a decision of the Tribunal constituted under this Schedule may appeal against such decision on a point of law to the Federal High Court upon giving notice in writing to the Secretary to the Tribunal within 30 days after the date on which such decision was given;

(ii) A notice of appeal filed pursuant to subparagraph (a) above shall set out all the grounds of law on which the appellant's case is based;

(iii) If the Service is dissatisfied with the decision of the Tribunal, it may appeal against such decision to the Federal High Court on points of law by giving notice in writing as specified in (a) to the Secretary within 30 days after the date on which such decision was given;

(iv) Upon receipt of a notice of appeal, the Secretary to the Tribunal shall cause the notice to be given to the Chief Registrar of the Federal High Court along with all the exhibits tendered at the hearing before the Tribunal;

(v) The Chief Judge of the Federal High Court may make rules providing for the procedure in respect of appeals made under this Act and until such rules are made, the Federal High Court rules relating to hearing of appeals shall apply to the hearing of an appeal under the Act.

2.7 Right to legal representation

(a) A complainant or appellant, as the case may be, may either appear in person or authorise one or more legal practitioners or any of its officers to represent him or its case before the Tribunal;

(b) Every individual or company in a case before the Tribunal shall be entitled to be represented at the hearing of an appeal by a solicitor or chartered accountant or adviser provided that, if the person appointed by the taxpayer to be representative in any matter before the Tribunal is unable for good cause to attend hearing thereof, the Tribunal may adjourn the hearing for such reasonable time as it deems fit, or admit the appeal to be made by some other person or by way of a written address.

2.7.1 Powers and procedures of the Tribunal

(a) The Tribunal may make rules regulating its procedures.

(b) The Tribunal shall, for the purposes of discharging its functions under this Schedule, have power to:

(i) Summon and enforce the attendance of any person and examine him on oath;
(ii) Require the discovery and production of documents;
(iii) Receive evidence on affidavits;
(iv) Call for the examination of witnesses or documents;
(v) Review its decisions;
(vi) Dismiss an application for default or deciding matters exparte;
(vii) Set aside any order or dismissal of any application for default or any order passed by it exparte; and
(viii) Do anything which in the opinion of the Tribunal is incidental or auxiliary to its functions under this Schedule.

(c) Any proceeding before the Tribunal shall be deemed to be a judicial proceeding and the Tribunal shall be deemed to be a civil court for all purposes.
(d) The Minister may make rules prescribing the procedure to be followed in the conduct of appeals before the Tribunal.
(e) However, each party to an appeal shall bear its own cost.

2.8 Further appeals to the Court of Appeal and Supreme Court

An appeal against the decision of the Federal High Court at the instance of either party shall lie to the Court of Appeal. Meanwhile, an aggrieved party can further challenge the matter at the Supreme Court.

2.9 Chapter review

This chapter gives a comprehensive procedure for appeals to the Tax Appeal Tribunals (TAT) where the taxpayer and the Revenue cannot mutually agree on the tax due. It discusses the composition of TAT and matters relating to Appeal Commissioners and other staff such as appointment, tenure of office, and so on.

The right of appeal of a taxpayer and the tax authority to seek further redress from the Federal High Court, Court of Appeal and Supreme Court is also discussed.

In addition, decided cases on different areas of dispute between taxpayers and tax officials are discussed.

In conclusion, good knowledge of the procedure for appeals to the Tax Appeal Tribunal and decided tax cases will improve tax practice in the country. Areas of conflict between tax practitioners and tax officials will be reduced considerably and this will be better for the country.

2.10 Worked examples

2.10.1 Open-ended questions

(1) Your firm has been the tax consultants to Murideen Limited for the past five years. The company makes up accounts to 31 December each year.

You submitted the company's tax returns to the Federal Inland Revenue Service, Lagos on June 24, 2012.

On July 28, 2012, the company forwarded to your office a BOJ assessment notice served on it on July 27, 2012 and dated July 20, 2012, with number LC/0005/12.

The tax computations which you submitted on behalf of your client showed ₦1,150,000 as tax payable, but the BOJ assessment notice showed a total profit of ₦13,150,000 and tax payable of ₦3,945,000.

The accounts also contained information on a Mercedes Benz Tractor purchased during the 2010 accounting year, for the sum of ₦250,000,000 which developed some fault and a sum of ₦10,000,000 was spent in repairing it during 2011 accounting year.

You did object to the BOJ and it was discharged. However, during the course of examination of the accounts, the tax inspector disallowed the expenses on the tractor and added it back to the profit to form the basis of an additional assessment of ₦3,000,000.

You duly objected to the additional assessment but the tax inspector stood his ground and sent a final demand notice for the additional assessment.

Required:

(a) Prepare the specimen letter of objection to the Federal Inland Revenue Service, Lagos Office on the BOJ assessment sent to the company.

(b) Identify the steps to be taken to seek redress in respect of the additional tax.

(2) State **five** powers of the Tax Appeal Tribunal.

(3) What are the contents of notice of appeal to be filed by taxpayers with Tax Appeal Tribunal?

2.10.2 Suggested solutions to open-ended questions

(1) (a) (**XYZ & Co. (Chartered Accountants)**
3, Aina Street, Ojodu, Lagos.

Our Reference (O/R) Your Reference (Y/R)

10 August 2012

The Chairman
Federal Inland Revenue Service
Integrated Tax Office
Broad Street
Lagos.

Dear Sir,

MURIDEEN LIMITED
RE: NOTICE OF OBJECTION TO BOJ ASSESSMENT

We write on behalf of our above-named client and wish to acknowledge the receipt of your notice of assessment as detailed below:

Assessment notice no.	: LC/0005/12 Date
of assessment	: July 20, 2012
Date of delivery	: July 27, 2012
Period of assessment	: 1/1/2011 - 31/12/2011

Total profit : ₦13,150,000
Tax payable : ₦ 3,945,000

We write to object to the said assessment based on the following grounds:

(a) That the Best of Judgement assessment of ₦3,945,000 is arbitrary, excessive, punitive and without a valid basis;

(b) The returns for the assessment year 2012 based on the accounts for the year ended December 31, 2011, were filed on June 24, 2012, which was within the due date.

(c) The tax computations, the duly filed self assessment form together with the tax receipts were included in the returns, all of which have been disregarded by you.

We, therefore, appeal to you to discharge the Best of Judgement assessment raised on our client and accept the tax returns already sent to your office.

Whilst looking forward to receiving your letter of discharge, we use this opportunity to thank you for your understanding and co-operation.

Yours faithfully,
For: XYZ & Co.

Peter Saint
For: Managing Partner

(1) (b) Steps to resolve the additional tax

(i) Write to object to the final demand notice of the additional assessment raised.
(ii) In the objection letter, refer to the relevant section of CITA (sec.20) that states that expenses on repairs and cost of spare parts for plant, tools etc; are to be treated as allowable expenses for income tax purposes.
(iii) Schedule a reconciliation meeting with the tax inspector.
(iv) Ensure that you receive a response from the inspector in writing, communicating their position based on the reconciliation meeting you had with them.
(v) After the meeting, if they refuse to discharge the demand notice, advise your client to proceed to the Tax Appeal Tribunal (TAT).
(vi) File a notice of appeal with the Tax Appeal Tribunal and serve the tax office a copy of the notice of appeal.

Chapter 3: Loss relief

(vii) Attend the Appeal Tribunal with relevant documents to prove that the expense was wholly incurred by your client.

(viii) If the decision of the Tax Appeal Tribunal is not favourable, advise your client to arrange for a legal adviser in order to commence court proceedings up to Supreme Court.

(2) The Tax Appeal Tribunal has powers to:
(i) Summon and enforce the attendance of any person and examine him/her

on oath;

(ii) Request for the discovery and production of documents;

(iii) Receive evidence on affidavits;

(iv) Call for the examination of witnesses or documents;

(v) Review its decisions;

(vi) Dismiss an application for default or deciding matters exparte;

(vii) Set aside any order or dismissal of any application for default or any order passed by it exparte;

(viii) Do anything which in the opinion of the Tribunal is incidental or ancillary to its functions.

(3) Contents of notice of appeal

Any company which is aggrieved by an assessment made upon it and has failed to agree with the Board, may appeal against the assessment to the Tax Appeal Tribunal upon giving notice in writing to the Board within 30 days after the date of service upon such company of notice of the refusal of the Board to amend the assessment as desired.

The notice of appeal should state the following:

(a) The official number of the assessment and the year;

(b) The amount of tax charged by such assessment;

(c) The amount of Total profits upon which tax is charged;

(d) The date upon which the appellant was served with notice of refusal by the Board to amend the assessment;

(e) The precise grounds of appeal; and

(f) An address of service of any notices and documents

3

Domestic tax policy

Content

3.0 Purpose

After studying this chapter, readers should be able to know:

(a) The objectives of the National tax policy;
(b) The policy guidelines under the National tax policy;
(c) The principles and canons of tax policy;
(d) The responsibilities of the stakeholders under the National tax policy;
(e) The interaction of fiscal, monetary and trade policies;
(f) The mandate of tiers of government under the National tax policy; and
(e) The Implementation measures under the National tax policy.

3.1 Introduction

The national tax policy, 2017 is a tax policy that provides fundamental guidelines for the orderly development of the Nigeria tax system.

3.1.1 Meaning of canons of taxation

Canons of taxation refer to the characteristics or qualities which a good tax system should possess. They relate to the administrative part of a tax. It should be noted that modern governments apply these cannons while imposing and collecting taxes.

3.1.2 Types of canons of taxation

These are as follows:

(a) **Canon of equality**

Canon of equality states that the burden of taxation must be distributed equally or equitably among the taxpayers. However, this sort of equality robs of justice because not all taxpayers have the same ability to pay taxes. Rich people are capable of paying more taxes than poor people. Thus, justice demands that a person having greater ability to pay must pay large taxes.

If everyone is asked to pay taxes according to his ability, then sacrifices of all taxpayers become equal. This is the essence of canon of equality (of sacrifice). To establish equality in sacrifice, taxes are to be imposed in accordance with the principle of ability to pay. In view of this, canon of equality and canon of ability are the two sides of the same coin.

(b) **Canon of certainty**

The tax which an individual has to pay should be certain and not arbitrary. According to A.

Smith, the time of payment, the manner of payment, the amount to be paid, i.e., tax liability, ought all to be clear and plain to the taxpayer and to everyone. Thus, canon of certainty embraces a lot of things. It must be certain to the taxpayer as well as to the tax-levying authority.

Not only taxpayers should know when, where and how much tax is to be paid. In other words, the certainty of liability must be known beforehand. Similarly, there must also be certainty of revenue that the government intends to collect over the given time period. Any amount of uncertainty in these respects may invite a lot of trouble.

(c) **Canon of economy**

This canon implies that the cost of collecting a tax should be as minimum as possible. Any tax that involves high administrativecost and unusual delay in assessment and high collection of taxes should be avoided altogether.

(d) **Canon of convenience**

Taxes should be levied and collected in such a manner that it provides the greatest convenience not only to the taxpayer but also to the government. Thus, it should be painless and trouble-free as far as practicable.

(e) **Canon of productivity**

According to a well-known classical economist in the field of public finance, Charles F. Bastable, taxes must be productive or cost- effective. This implies that the revenue yield from any tax must be a sizable one. Further, this canon states that only taxes that do not hamper productive effort of the community should be imposed. A tax is said to be a productive one only when it acts as an incentive to production.

(f) **Canon of elasticity**

Modern economists attach great importance to the canon of elasticity. This canon implies that a tax should be flexible or elastic in yield. It should be levied in such a way that the rate of taxes can be changed according to exigencies of the situation. Whenever the government needs money, it must be able to extract as much income as possible without generating any harmful consequences through raising tax rates. Income tax satisfies this canon.

(g) **Canon of simplicity**

Every tax must be simple and intelligible to the people so that the taxpayer is able to calculate it without taking the help of tax consultants. A complex as well as a complicated tax is bound to yield undesirable side-effects. It may encourage taxpayers to evade taxes if the tax system is found to be complicated.

A complicated tax system is expensive in the sense that even the most honest educated taxpayers will have to seek advice of tax consultants. Ultimately, such a tax system has the potentiality of breeding corruption in the society.

(h) **Canon of diversity**

Taxation must be dynamic. This means that a country’s tax structure ought to be dynamic and diverse in nature rather than being narrow and rigid. Diversification in a tax structure will demand involvement of the majority of the sectors of the population and must evolve over time as new economic activities are created.

A dynamic or a diversified tax structure will result in the allocation of burden of taxes among the vast population resulting in a low degree of incidence of a tax in the aggregate.

The above canons of taxation are considered to be essential requirements of a good tax policy. Unfortunately, such an ideal tax system is rarely observed in the real world but a tax authority must go on maintaining relentlessly the above canons of taxation so that a near- ideal tax structure can be built-up.

3.1.3 Characteristics or canons of taxation

A good tax system has to fulfill the following characteristics:

(a) The distribution of tax burden should be equitable such that every person is made to pay his **'fair share'**. This is known as the '**fairness' criterion which focuses on two principles: Horizontal equity** — equals should pay equal taxes; and **vertical equity** — unequal should pay unequal taxes. That is to say, rich people should pay more taxes;

(b) Equity must not hamper productive efficiency such that burdens should be provided to correct inefficiencies. This **'efficiency'** criterion says that it should raise revenue with the least costs to the taxpayers so that tax system can allocate resources without distortion;

(c) The two other criteria are: 'flexibility' and 'transparency';

(d) A good tax system demands changes in tax rates whenever circumstances change in the system. Furthermore, it must be transparent in the sense that taxpayers should know what they are paying for the services they are getting; and

(e) A good tax system is expected to facilitate the use of fiscal policy to achieve the goals of stability and economic growth. For the attainment of these goals, there must be built-in-flexibility in the tax structure.

From the above discussion, it follows that taxation serves the following purposes:

(i) To raise revenue for the government;
(ii) To redistribute income and wealth from the rich to the poor people;
(iii) To protect domestic industries from foreign competition; and
(iv) To promote social welfare.

3.2 Advice on the key provisions and applications of the 2017 National Tax Policy in Nigeria

For the purpose of the National Tax Policy, "tax" is any compulsory payment to government imposed by law without direct benefit or return of value or a service whether it is called a tax or not. The policy is now applicable to all the tiers of government in Nigeria. It establishes fundamental principles to guide an orderly development of the Nigeria tax system and reinforces the need for tax laws and administrative practices to promote economic development.

3.2.1 Objectives of the national tax policy

The Policy is expected to achieve the following specific objectives, among others:

(a) Guide the operation and review of the tax system;
(b) Provide the basis for future tax legislation and administration;
(c) Serve as a point of reference for all stakeholders on taxation;
(d) Provide benchmark on which stakeholders shall be held accountable; and
(e) Provide clarity on the roles and responsibilities of stakeholders in the tax system.

3.2.2 Guiding principles of Nigeria tax system

According to the new National tax policy, all existing and future taxes are expected to align with the following fundamental features:

(a) **Equity and fairness:** Nigeria tax system should be fair and equitable devoid of discrimination. Taxpayers should be required to pay according to their ability;

(b) **Simplicity, certainty and clarity:** Tax laws and administrative processes should be simple, clear and easy to understand;

(c) **Convenience:** The time and manner for the fulfilment of tax obligations shall take into account the convenience of taxpayers and avoid undue difficulties;

(d) **Low compliance cost:** The financial and economic costs of compliance to the taxpayer should be kept to the barest minimum;

(e) **Low cost of administration:** Tax administration in Nigeria should be efficient and cost-effective in line with international best practices;

(f) **Flexibility:** Taxation should be flexible and dynamic to respond to changing circumstances in the economy in a manner that does not retard economic activities; and

(g) **Sustainability:** The tax system should promote sustainable revenue, economic growth and development. There should be a synergy between tax policies and other economic policies of government.

3.2.3 Relevance of the tax system to wealth creation and employment as provided for in the national tax policy

The tax system should be designed to promote social, political and economic development. Accordingly,

(a) Tax policies and laws shall not be retroactive;
(b) Tax policies and laws should ensure equal investment opportunities and support for businesses whether local or foreign;
(c) Tax policies and laws on investments should be long term focused and tenured to enable investors plan with reasonable certainty;
(d) Any incentive to be granted should be broad, sector based, tenured and transparent. Implementation should be properly monitored, evaluated, periodically reported and kept under review;
(e) Revenue forgone from tax incentives or concessions should be quantified against expected benefits and reported annually. Where the benefits cannot be quantified, qualitative factors must be considered; and
(f) Tax policies on investments should not promote monopoly such as entry barriers or otherwise prevent competition.

The National tax policy (NTP) establishes fundamental principles to guide an orderly development of the Nigeria tax system and reinforces the need for tax laws and administrative practices to promote economic development. When fully implemented, the policy will address key challenges confronting the Nigeria tax system including:

(a) Low tax to GDP ratio;

(b) Fragmented database of taxpayers and weak structure for exchange of information;

(c) Multiplicity of taxes and revenue agencies;

(d) Poor accountability for tax revenue;

(e) Use of aggressive and unorthodox methods for tax collection;

(f) Failure by tax authorities to honour refund obligations to taxpayers; and

(g) The non-regular review of tax legislation, which has led to obsolete laws, that do not reflect current economic realities.

Some of the key recommendations that have been included to address the challenges are as follows:

(a) Ensuring that there is only one revenue agency per level of government;

(b) Establishment of a tax court as an independent body to adjudicate in tax matters;

(c) Lower tax rate and VAT compliance threshold for SMEs;

(d) Establishment of an office of tax simplification for continuous improvement to tax legislations and administration and develop key performance indices for Nigeria to attain a top 50 position on the global index of ease of paying taxes by 2020 and consistently improve on the ranking;

(e) Administrative framework for amnesty and whistle blowing as part of the strategies for curbing evasion and widening the tax net; and

(f) INEC to mandate political parties to articulate, prepare, provide and make public their tax agenda before and during election campaigns.

3.2.4 Responsibilities of the stakeholders under the National tax policy

(a) **The government**

All levels and arms of government, ministries, extra-ministerial departments and agencies where applicable shall:

(i) Implement and regularly review tax policies and laws;

(ii) Provide information on all revenue collected on a quarterly basis;

(iii) Ensure adequate funding, administrative and operational autonomy of tax authorities; and

(iv) Ensure a reasonable transition period of between three and six months before implementation of a new tax.

(b) **The taxpayer**

A taxpayer is a person, group of persons or an entity that pays or is liable to tax. The taxpayer is the most critical stakeholder and primary focus of the tax system. The taxpayer shall consider tax responsibilities as a civic obligation and constant duty that must be discharged as and when due. The taxpayer shall be entitled to:

(i) Relevant information for the discharge of tax obligations;

(ii) Receive prompt, courteous and professional assistance in dealing with tax authorities;

(iii) Raise objections to decisions and assessments and receive response within a reasonable

time;
(iv) A fair and impartial appeal; and
(v) Self-representation or by any agent of choice, provided an agent acting for financial reward shall be an accredited tax practitioner.

(c) **Revenue agencies**

Any agencies responsible for the collection and administration of revenue shall:
(i) Treat the taxpayer as a customer;
(ii) Ensure efficient implementation of tax policies, laws and international treaties;
(iii) Facilitate inter-agency co-operation and exchange of information;
(iv) Undertake timely audits and investigations;
(v) Undertake tax awareness and taxpayers' education; and
(vi) Establish a robust process to prevent, detect and punish corrupt tax officials.

(d) **Professional bodies, tax practitioners, consultants and agents**

Professional bodies shall:
(i) Act in accordance with professional code of conduct and ethics;
(ii) Not aid and abet tax evasion and corrupt practices; and
(iii) Actively promote effective tax compliance.

(e) **Media and advocacy groups**

Media and advocacy groups shall:
(i) Promote tax education and awareness
(ii) Articulate, protect and advance taxpayers right
(iii) Advance accountability and transparency in the utilization of tax revenue
(iv) Ensure accurate, objective and balanced reporting in accordance with their professional code of conduct and ethics; and
(v) Ensure that aspiring political office holders clearly understand the tax policy and the Nigeria tax system and are able to articulate their plans for the tax system to which they will be held accountable

3.2.5 Mandates of the three-tiers of government under the National tax policy

Tax authorities at all levels shall administer their mandates in accordance with the following:

(a) **Registration of taxable persons**

All taxable persons shall be registered and issued with taxpayer identification number (TIN) applicable nationwide. Tax authorities should leverage on the database of the Central Bank of Nigeria (CBN) on Bank Verification Number (BVN), National Identity Management Commission (NIMC), Nigeria Communication Commission (NCC), Corporate Affairs Commission (CAC), Federal Road Safety Commission (FRSC), Nigeria Immigration Service (NIS) and other relevant sources. The current uncoordinated registration by different agencies should be harmonized.

(b) **Tax compliance**

Government shall apply all available resources and tools at their disposal to ensure that taxpayers voluntarily comply with their tax obligations. In order to improve voluntary compliance, the relevant authorities should ensure:

(i) That the option for self-assessment is in place, and the process and procedures are simple
(ii) Development of frameworks for tax amnesty in order to expand the tax net
(iii) Focus on taxpayers' services, Constant tax education and enlightenment
(iv) The overall performance of the tax system is measured and reported periodically, and
(v) The establishment of a system to recognize and honour compliant taxpayers.

(c) **Efficiency of administration**
The following are important in ensuring an efficient tax administration:

(i) Payment processing and collection; and
(ii) Collection system shall leverage on modern technology towards advancing ease of payment and prevention of revenue losses.

(d) **Record keeping**
Tax authorities shall partner with the relevant agencies to set up automated systems and adequately train tax officials in the use and maintenance of such systems. Electronic systems of record keeping in line with global best practices should be entrenched to enhance the tax administration process.

(e) **Exchange of information**
Tax authorities shall develop an efficient framework for cooperation and sharing of information with other tax authorities and relevant local and international agencies. This will mitigate tax evasion and revenue losses.

(f) **Enforcement of tax laws**
Tax authorities shall ensure the enforcement of civil and criminal sanctions as provided under the various tax laws.

(g) **Funding of tax authorities**
Government shall provide adequate funding for tax authorities. Accordingly, government should ensure that an adequate percentage of revenue collected should be provided to the authority for its operations.

(h) **Funding for tax refunds**
Government shall provide adequate funding to meet refund obligations. Tax authorities shall ensure timely and efficient payment of refunds.

(i) **Ease of paying taxes**
Tax authorities shall ensure that payment procedures and documentation are convenient and cost effective. Tax authorities shall work towards ensuring accelerated improvement on the global index of ease of paying taxes.

(j) **Revenue autonomy**

Governments shall ensure a reasonable level of financial and administrative autonomy for their respective tax authorities to facilitate effective discharge of their duties.

(k) Technology and tax intelligence

Tax authorities shall ensure:

(i) Deployment of technology to aid all aspects of tax administration;

(ii) The integrity and regular update of the database; and

(iii) A workable and secure structure for intelligence and information gathering.

(l) Dispute resolution

In the event of any dispute, the tax authority and relevant stakeholders shall leverage on all amicable means of dispute resolution including arbitration and only resort to judicial determination as a last resort.

3.2.6 Implementation measures under the National tax policy

The Federal Ministry of Finance has a pivotal role to play in the development and implementation of the tax policy. Accordingly, the ministry shall take appropriate steps to ensure that it receives cooperation from the following:

(a) **The President and governors**

The president and governors shall ensure that budget speeches and presentations for the fiscal year consistently contain the overriding fiscal policies and summary statements of the expected tax revenue. This will give key stakeholders a sense of what government plans to do and enable them to plan accordingly.

The president and governors should work towards ensuring that there is only one revenue agency per level of government. This would streamline revenue administration and improve efficiency of revenue collection. Ministries, extra-ministerial departments and agencies other than tax authorities should not become tax collecting bodies.

The executive shall sponsor a bill for the establishment of a tax court as an independent body to adjudicate in tax matters.

(b) **Legislature**

The consideration and passage of tax bills have not fared well within the existing finance committee of the National and state houses of assembly. The National and state houses of assembly are encouraged to establish a taxation committee to focus on tax matters and collaborate with the tax policy implementation committee.

There shall be an establishment Act for the Joint Tax Board towards strengthening and repositioning it to contribute meaningfully to the development of the Nigeria tax system through broader mandate beyond its current advisory role.

The qualification for the lower income tax rate applicable to small businesses should be reviewed in line with current economic realities. The income tax rate for small businesses should be further reduced as an incentive to encourage compliance and promote micro, small and medium enterprises (MSMEs).

(c) **Ministry of Finance**

The Ministry of Finance shall:

(i) Set in motion machinery for tax reform. Taxation is a dynamic tool. Having reviewed the policy, the tax law and administration cannot remain stagnant. It is imperative to streamline existing and future tax laws for an orderly development;

(ii) Establish a tax policy implementation committee to monitor compliance, regularly review the

(iii) policy and make appropriate recommendations;

(iv) Ensure automation of collection and remittance processes of taxes by all ministries, extra-ministerial departments and agencies;

(v) Work with the legislature to ensure that the requisite changes to tax laws are enacted together with the appropriation Act of the same year. This would require the executive to timely present tax laws as executive bill for the timely consideration of the National and state houses of assembly;

(vi) Establish an office of tax simplification which shall be responsible for ensuring continuous improvement to tax legislation and administration;

(vii) Create a dedicated tax policy website. Apart from sensitizing the general public on the provisions of the tax policy, such a platform would facilitate feedback from stakeholders on the existing and future policy proposals;

(viii) Give periodic reports to the National economic council (NEC) on tax policy implementation agenda. Apart from updating NEC, such obligation will ensure that the Ministry of finance is up to speed in its implementation agenda;

(ix) Ensure that tax authorities develop key performance indices for Nigeria to attain a top 50 position on the global index of ease of paying taxes by 2020 and consistently improve on the ranking; and

(x) Ensure that there is a minimum threshold for VAT registration and compliance in order to protect micro-businesses.

(d) Ministries, department and agencies (MDAs)

Heads of MDAs shall give periodic report(s) to the Ministry of Finance on the level of implementation of the National Tax Policy. Apart from sensitizing the MDAs to the provisions of the tax policy, such reports would afford the Ministry of Finance the opportunity to determine the level of compliance and devise appropriate responses as may be necessary to improve implementation.

(e) Tax authorities

To promote tax awareness and a tax culture in Nigeria, the federal and state tax authorities through the Joint Tax Board (JTB) shall set aside a uniform day in the year as a national tax day. Also, government should make concerted efforts to ensure that taxation is taught at all levels of education.

Tax authorities shall establish administrative framework for amnesty and whistle blowing as part of the strategies for curbing evasion and widening the tax net.

Federal and state tax authorities should respond promptly to the changing business environment as it affects tax administration and develop a workable framework to meet the taxpayers' demands in this respect.

(f) Independent National Electoral Commission (INEC)

The Independent National Electoral Commission (INEC) shall, by necessary regulation and rules, mandate political parties to articulate, prepare, provide and make public their tax agenda before and during election campaigns. This will make political parties reflect more deeply in an organized fashion on the financial implications of their promises and the options of financing them. This would also help the taxpayer know the preferences of each party on tax matters and take informed decision.

3.3 The interaction of fiscal policy, monetary policy and trade policy

3.3.1 Introduction

Macroeconomic policies are seen to be very important for the stability and growth of the economy. However, unfavorable macroeconomic policies can create uncertainty in the economy which will discourage investment. Also, uncertainty in an economy will reduce the potential of long run economic growth. Every government has an objective to increase the living standard of people by providing employment and stability in the economy whether it is an under developed, developing or developed country. Governments use two main types of policies for achieving these objectives which are fiscal and monetary policy. On the other hand, trade policy of a country is also important for prosperity of the economy. It will increase productivity of a country and increase living standard of people as well as growth of economy (Adeeb et al., 2014).

3.3.2 The fiscal policy

This is implemented by the Ministry of Finance and has to do with changes in government expenditure, taxation and government borrowing to control the economic conditions and achieve rapid economic growth.

The term fiscal policy has conventionally been associated with the use of taxation and public expenditure to influence the level of economic activities. The implementation of fiscal policy is essentially routed through government's budget. The budget is, therefore, more than a plan for administering the government sector. It both reflects and shapes a country's economic life. In fact, the most important aspect of a public budget is its use as a tool in the management of a nation's economy (Omitogun and Ayinla, 2007).

Fiscal policy deals with government deliberate actions in spending money and levying taxes with a view to influencing macro-economic variables in a desired direction. This includes sustainable economic growth, high employment creation and low inflation. Thus, fiscal policy aims at stabilizing the economy spending or a reduction in taxes tend to pull the economy out of a recession; while reduced spending or increased taxes slow down a boom (Dornbusch and Fischer, 1990).

Fiscal policy is also used to reconcile the changes which government modifies in taxation and expenditure, programmes or to regulate the full employment, price and total demand to be used through instruments such as government expenditures, taxation and debt management (Hottz- Eakin, Lovely and Tosin, 2009).

As noted by Anyanwu (1993), the objective of fiscal policy is to promote economic conditions conducive to business growth while ensuring that any such government actions are consistent with economic stability.

In principle, fiscal dominance occurs when fiscal policy is set exogenously to monetary policy in an environment where there is a limit to the amount of government debt that can be held by the public. Hence, if the inter- temporal budget constraint must be satisfied, fiscal deficits would have to be magnetized, sooner or later. In fact, when the size of the financial system is small relative to the size of the fiscal deficits, a central bank may have no choice but to magnetize the deficits. Thus in countries with shallow financial systems, monetary policy is the reverse side of the coin of fiscal policy and can only play an accommodative role. In such low income countries, government securities markets are underdeveloped and central banks do not hold sufficient amounts of tangible securities and the central bank's lack of suitable and adequate instruments of monetary control constitutes one of the factors that induce fiscal dominance. Where fiscal dominance applies, the country's economic policy is only as good as its fiscal policy and institutionalized central bank independence may not necessarily bring about an independent monetary policy (Oyejide, 2003).

3.3.3 The monetary policy

This is implemented by the central bank and it involves policies aimed at controlling the stock of money in the economy which has the potential of reducing inflation and increasing productivity.

Monetary policy is concerned with discretionary control of money supply by the monetary authorities (Central Bank with Central Government) in order to achieve stated or desired economic goals. Governments try to control the money supply because most governments believe that its rate of growth has an effect on the rate of inflation. [***International Journal of Academic Research in Economics and Management Sciences***
September 2012, Vol. 1, No. 5 ISSN: 2226-3624]

Monetary policy is the deliberate use of monetary instruments (direct and indirect) at the disposal of monetary authorities such as central bank in order to achieve macroeconomic stability. Monetary policy is essentially the tool for executing the mandate of monetary and price stability.

Monetary policy is essentially a programme of action undertaken by the monetary authorities generally the central bank, to control and regulate the supply of money with the public and the flow of credit with a view to achieving predetermined macroeconomic goals (Dwivedi, 2005).

Monetary policy is one of the tools of controlling money supply in an economy of a nation by the monetary authorities in order to achieve a desirable economic growth. Monetary policies are effective only when economies are characterized by well developed money and financial markets like developed economies of the world. This is where a deliberate change in monetary variable influences the movement of many other variables in the monetary sector.

Monetary policy consists of a government's formal efforts to manage the money in its economy in order to realize specific economic goals. Three basic kinds of monetary policy decisions can be made about:

(a) The amount of money in circulation;
(b) The level of interest rate; and
(c) The functions of credit markets and the banking system (Ogunjimi, 1997).
The combination of these measures is designed to regulate the value, supply and cost of money in an economy, in line with the level of economic activity. Excess supply of money will result in an excess demand for goods and services, prices will rise and balance of payments will deteriorate. The challenge of monetary policy management rest wholly on monetary authorities which has over the years been committed to its effective control.

As noted by Babangida (1993), the lack of fiscal discipline is the bane of our economy. In spite of realized revenues being above budgetary estimates, extra budgetary expenditure has been rising so fast and resulting in ever bigger deficit. To say the least, this is a sobering revelation and we must all ensure that the deficit is not only minimized but eventually eliminated.

3.3.4 Trade policy

This involves measures taken by government, in addition to exchange rate policy, to influence the magnitude and the direction of foreign trade. Studies found the positive role of trade openness in economic growth.

Trade openness increases the efficiency in the production process which affects economic activities.

3.3.5 Summary

The three policies have the long-run objective of achieving economic growth in a country.

There is consensus on the role of these macroeconomic policies in determining the economic growth. The relationship of macroeconomic policies and economic growth has very much importance and has engaged economists and policy makers to analyze the role of macroeconomic policies on economic growth.

Fiscal and monetary policies are inextricably linked in macro-economic management; developments in one sector directly affect developments in the other. Undoubtedly, fiscal policy is central to the health of any economy, as government's power to tax and to spend affects the disposable income of citizens and corporations, as well as the general business climate and international trade.

3.4 Chapter review

This chapter gives a comprehensive overview of the National tax policy, stating its key objectives and relevance of a good tax system to wealth creation and employment opportunities.

The chapter also dwells on the responsibilities of the stakeholders and implementations measures under the National tax policy.

3.5 Worked examples

3.5.1 Open-ended questions

1 i. What are the components of a tax system?
ii. Discuss the guiding principles for the Nigeria National Tax policy.

2. Identify and examine the stakeholders and their respective responsibilities under the National tax policy.
3. Efficient tax administration has been identified as key to successful implementation of the National Tax Policy in Nigeria. Therefore, the National Tax Policy highlighted some measures that will enhance efficient tax administration in Nigeria.

Required:
Identify and explain the measures that will enhance efficient tax administration in Nigeria as stipulated in the National Tax Policy.

3.5.2 Suggested Solutions to open-ended questions

i. **The tax system is a combination of the tax policy, the tax laws and the tax administration.**

Tax policy: The tax policies are general statements of intention, which guide the thinking and the action of all stakeholders towards the realization of the set tax goals e.g. emphasis on indirect tax which is less prone to tax evasion, self-assessment scheme to encourage taxpayer participation.

Tax laws: The tax laws give legal backing to tax imposition. Tax laws are reviewed periodically in line with the changes in social, political and economic conditions of the country.

Tax administration: This involves practical interpretations and application of the tax laws. The bodies charged with the administration of tax in Nigeria are the Federal, the State and Local governments.

(ii) **According to the new National tax policy, all existing and future taxes are expected to align with the following fundamental features:**

a. **Equity and fairness:** Nigeria tax system should be fair and equitable devoid of discrimination. Taxpayers should be required to pay according to their ability;

b. **Simplicity, certainty and clarity:** Tax laws andadministrative processes should be simple, clear and easy to understand;

c. **Convenience:** The time and manner for the fulfilment of tax obligations shall take into account the convenience of taxpayers and avoid undue difficulties;

d. **Low compliance cost:** The financial and economic costs of compliance to the taxpayer should be kept to the barest minimum;

e. **Low cost of administration:** Tax administration in Nigeria should be efficient and cost-effective in line with international best practices;

f. **Flexibility:** Taxation should be flexible and dynamic to respond to changing circumstances in the economy in a manner that does not retard economic activities; and

g. **Sustainability:** The tax system should promote sustainable revenue, economic growth and development. There should be a synergy between tax policies and other economic policies of government.

(2) The key stakeholders under the National tax policy and their respective responsibilities are:

(a) The government

All levels and arms of government, ministries, extra-ministerial departments and agencies where applicable shall:

(i) Implement and regularly review tax policies and laws;

(ii) Provide information on all revenue collected on a quarterly basis;

(iii) Ensure adequate funding, administrative and operational autonomy of tax authorities; and

(iv) Ensure a reasonable transition period of between three and six months before implementation of a new tax.

(b) **The taxpayer**

A taxpayer is a person, group of persons or an entity that pays or is liable to tax. The taxpayer is the most critical stakeholder and primary focus of the tax system. The taxpayer shall consider tax responsibilities as a civic obligation and constant duty that must be discharged as and when due. The taxpayer shall be entitled to:

(i) Relevant information for the discharge of tax obligations

(ii) Receive prompt, courteous and professional assistance in dealing with tax authorities

(iii) Raise objections to decisions and assessments and receive response within a reasonable time

(iv) A fair and impartial appeal

(v) Self-representation or by any agent of choice, provided an agent acting for financial reward shall be an accredited tax practitioner

(c) **Revenue agencies**

Any agencies responsible for the collection and administration of revenue shall:

(i) Treat the taxpayer as a customer
(ii) Ensure efficient implementation of tax policies, laws and international treaties
(iii) Facilitate inter-agency co-operation and exchange of information
(iv) Undertake timely audits and investigations
(v) Undertake tax awareness and taxpayers' education, and
(vi) Establish a robust process to prevent, detect and punish corrupt tax officials

(d) **Professional bodies, tax practitioners, consultants and agents**

Professional bodies shall:

(i) Act in accordance with professional code of conduct and ethics
(ii) Not aid and abet tax evasion and corrupt practices
(iii) Actively promote effective tax compliance.

(e) **Media and advocacy groups**

Media and advocacy groups shall:

(i) Promote tax education and awareness.
(ii) Articulate, protect and advance taxpayers right.
(iii) Advance accountability and transparency in the utilization of tax revenue.
(iv) Ensure accurate, objective and balanced reporting in accordance with their professional code of conduct and ethics; and
(v) Ensure that aspiring political office holders clearly understand the tax policy and the Nigeria tax system and are able to articulate their plans for the tax system to which they will be held accountable

(3) In line with the National Tax Policy, the following has been identified as measures that will enhance efficient tax administration in Nigeria:

(a) **Payment processing and collection**

Collection system shall leverage on modern technology towards advancing ease of payment and prevention of revenue losses.

(b) **Record keeping** Tax authorities shall partner with the relevant agencies to set up automated systems and adequately train tax officials in the use and maintenance of such systems. Electronic systems of record keeping in line with global best practices should be entrenched to enhance the tax administration process.

(c) **Exchange of information**

Tax authorities shall develop an efficient framework for cooperation and sharing of information with other tax authorities and relevant local and international agencies. This will mitigate tax evasion and revenue losses.

(d) **Enforcement of tax laws**
Tax authorities shall ensure the enforcement of civil and criminal sanctions as provided under the various tax laws.

(e) **Funding of tax authorities**
Government shall provide adequate funding for tax authorities. Accordingly, government should ensure that an adequate percentage of revenue collected should be provided to the authority for its operations.

(f) **Funding for tax refunds**
Government shall provide adequate funding to meet refund obligations. Tax authorities shall ensure timely and efficient payment of refunds.

(g) **Ease of paying taxes**
Tax authorities shall ensure that payment procedures and documentation are convenient and cost effective. Tax authorities shall work towards ensuring accelerated improvement on the global index of ease of paying taxes.

(h) **Revenue autonomy**
Governments shall ensure a reasonable level of financial and administrative autonomy for their respective tax authorities to facilitate effective discharge of their duties.

(i) **Technology and tax intelligence**
Tax authorities shall ensure:

- Deployment of technology to aid all aspects of tax administration;
- The integrity and regular update of the database; and
- A workable and secure structure for intelligence and information gathering.

(j) **Dispute resolution**
In the event of any dispute, the tax authority and relevant stakeholders shall leverage on all amicable means of dispute resolution including arbitration and only resort to judicial determination as a last resort.

4

Taxation of business and investment income (Companies income tax)

Content

TAXATION OF BUSINESS AND INVESTMENT INCOME (COMPANIES INCOME TAX)

4.0 Purpose

At the end of this chapter, the readers should be able to:

(a) Appreciate the procedure for assessing a limited liability company to tax;

(b) Know how a new and a ceasing business are subjected to tax;

(c) Know how a company that is changing its accounting date is treated for tax purposes

(d) Know the meaning, importance and relevance of bases period for assessments;

(e) Appreciate income and profit chargeable to tax in Nigeria;

(f) Appreciate the treatment of dividend and other investment income in Nigeria; and

(g) Appreciate profits and gains exempted from tax in Nigeria.

4.1 Legal framework for the imposition of taxes

This is the authority that enables the federal government to impose and collect taxes from the citizens of the Federal Republic of Nigeria. They are classified as follows:

(a) The Constitution of the Federal Republic of Nigeria provides for the exclusive and concurrent list. The list reserves for the Federal government the exclusive right to provide legislation on the taxation of incomes, profits and capital gains; and

(b) Taxes and Levies (Approved List for Collection) Act CapT2 LFN 2004(as amended).

These relate to:

(i) Companies income tax (CIT);

(ii) Withholding tax (WHT) on companies, residents of FCT, Abuja and non-residents;

(iii) Petroleum profits tax (PPT)

(iv) Value added tax (VAT);

(v) Tertiary education tax (TET);

(vi) Capital gains tax (CGT) - companies and non-residents;

(vii) Stamp duties on companies and non-residents ;

(viii) Personal income tax (PIT) in respect of members of Armed forces, Police forces and staff of Foreign Affairs Ministry and non-resident individuals

The following legislations guide the imposition of taxes in Nigeria:

- Petroleum Profits Tax Act Cap P12 LFN, 2004; (as amended);
- Companies Income Act Cap C21 LFN, 2004 (as amended);
- Companies Income Tax Amendment Act, 2007;
- Capital Gains Tax Act Cap C1 LFN, 2004; (as amended);
- Tertiary Education Tax Act Cap E4 LFN, 2004(as amended);
- Personal Income Tax Act Cap P8 LFN, 2004 and AmendmentAct, 2011;

- Value Added Tax Act Cap V1, LFN 2004 and VAT AmendmentAct, 2007;
- Stamp Duties Act 1939 now Stamp Duties Act CAP S.8 LFN 2004 ; (as amended);
- Federal Inland Revenue Service (Establishment) Act, 2007 CAP F 36;
- Other subsidiary legislations. (e. g. IDA CAP 17 LFN 2004); and
- Income Tax (Transfer Pricing) Regulations 2018.

4.2 Background to Companies Income Tax Act (CITA)

The authority to charge limited liability companies operating in Nigeria to tax is contained in the Companies Income Tax Act Cap C21 LFN 2004(as amended) . The procedures are contained also in the same Act and subsidiary legislation. For this purpose, distinction is made between Nigerian and non- Nigerian companies. A Nigerian company is defined as one incorporated under the Companies and Allied Matters Act, (CAMA) 2004 (as amended). A foreign company [Non-Nigerian Company] is defined as any company or corporation established by or under any law in force in any territory or country outside Nigeria, that is, a company that is not incorporated under CAMA.

The income of a Nigerian company is assessable to Nigerian tax irrespective of where it was derived and notwithstanding that it has not been brought into or received in Nigeria. Whereas the income of a non- Nigerian company shall be subject to Nigerian tax only to the extent to which such income is attributable to the company's operations in Nigeria. The procedure for this class of companies shall be considered in later chapter dealing with international taxation.

4.2.1 Identification of a company

In accordance with the Sec.8 of the CITA, the incorporation number of a company and the Tax Identification Number (TIN) generated by the Federal Inland Revenue Service, shall serve as the identification number of the company and shall be displayed by the company on all business transactions with other companies and individuals and on every document, statement, returns, audited accounts and correspondence with Revenue Authorities, including the Nigeria Custom Service, ministries and all government agencies.

4.2.2 Trade or business

Companies are normally formed to carry out particular activities which will be specified in the "objects clause" of their respective memoranda of association. Therefore, in determining what constitutes a trade or business of a company, it is necessary to refer to the "objects clause" of its memorandum of association, to ascertain the activities that the company was registered to carry out. The carrying on of such activities will definitely constitute trade or business and the income there from will be subject to company's taxation in accordance with the provisions of the Act. Thus, a trade or business will include manufacturing and any other activities being carried on in pursuance of the goal for which the company was possible activities to keep it in business, it is only reasonable to conclude that the income from all such activities constitute chargeable transactions and will, therefore, be taxed, except if they relate to capital items or are specifically exempted by other provisions of the Act. Neither the absence of a profit-making motive in particular transactions nor the fact that they are isolated and do not relate to the company's normal business could prevent the income from such transactions from being subjected to companies taxation.

4.3 Bases of assessing companies to tax

Basis period: This is a defined period of time in the life a company. It is an accounting period which is related to any particular assessment year. All chargeable profits/income fallen within this period shall be assessed to tax as may be appropriate.

4.3.1 Relevant definitions

(a) **Basis Period**

This is defined as the basis upon which the tax liability of a company would be computed.

(b) **Tax year or year of assessment**

This is the government financial or fiscal year which runs from January 1 and ended December 31. It is also described as the income tax year. A company's accounting year will be related to the government's tax year in which the operating result of such company is to be assessed to tax.

(c) **Preceding year basis [PYB]**

This is the basis period that ended before the beginning of the government fiscal year or tax year. It means that the basis period of the taxpayer for the relevant tax year ends in the year before the tax year.

(d) **Actual year basis [AYB]**

This is the basis period that coincide with the government fiscal year running from January 1 to December 31 of every year.

(e) **Normal basis period**

A normal basis period is made up of 12 months. It will start immediately the previous tax year's basis period ends.

(f) **Abnormal basis period**

It is either less than or more than 12 months. It may not start immediately the previous tax year's basis period ends. There are three situations in the tax Acts leading to abnormal basis period. These are:

(i) When there is commencement of new trade or business;
(ii) When there is cessation of existing trade or business; and
(iii) When there is a change of accounting date. [The general rules for determining basis period of assessments are contained in Section 25 of CITA].

4.3.2 Basis period on commencement of new trade or business

The basis of assessing such a business to tax for the three years is as stated below:

Section 29 (3) of CITA (as amended) provides that "the assessable profits of any company from any trade or business (or in the case of a company other than a Nigerian company) for its first year of assessment and the two following years of assessment (which years are in this subsection respectively referred to as "the first year", "the second year" and "the third year") shall be ascertained in accordance with the following:

(a) For the first year, the assessable profits shall be the profits from the date in which it commenced to carry on such trade or business in Nigeria to the end of its first accounting period;

(b) For the second year, the assessable profits shall be the profits from the first day after its first accounting period to the end of its second accounting period; and

(c) For the third year and for each subsequent year, the assessable profits shall be the profits from the day after the accounting period just ended.

Fourth and subsequent years

The preceding year basis rule will apply.

Illustration 4.1

XYZ Limited commenced business on March 1, 2020, and makes up accounts to October 31, each year.

Required:

State the relevant assessment year and the profits to be assessed.

Solution 4.1

The first assessment year is 2021 and the profits to be assessed will relate to March 1, 2020 to October 31, 2020.

Illustration 4.2

XYZ Limited commenced business on April 1, 2020 and makes up accounts to November 30, each year.

Required:

Determine the basis periods for the first four years of assessment

Solution 4.2

XYZ Limited basis periods for the first four years of assessment

YOA	Basis period
2021	1/4/2020 – 30/11/2020
2022	1/12/2020 – 30/11/2021
2023	1/12/2021 – 30/11/2022
2024	1/12/2022 – 30/11/2023

Ascertainment of the end of the first accounting period

The ascertainment of the end of the first accounting period is key in the determination of basis period and the first year of assessment.

The first accounting period begins from the date of commencement of business to the end of its first accounting year-end.

In a situation where a company prepares the audited financial statements for a period shorter or longer than the first accounting period, the assessable profits for the first accounting year will be determined on pro-rata basis.

Illustration 4.3

Orion Limited was incorporated in December 2018 and commenced business on October 1, 2019. The first set of financial statements prepared by the company covered a period of 15 months, that is October 1, 2019 to December 31, 2020 and the adjusted profit was ₦3,000,000.

Required:

Ascertain the relevant basis periods and the assessable profits for the relevant assessment years.

Solution 4.3

Orion Limited

Ascertainment of the relevant basis periods and assessable profits for the relevant assessment years

YOA	**Basis period**	**Assessable profit**
		N
2019	1/10/19 – 31/12/19	600,000
2020	-	0
2021	1/1/20 – 31/12/20	2,400,000
		3,000,000

Arising from the above, the company did not have any assessable profit for A.Y. 2020, hence it will not pay companies income tax.

Given the provisions of the Finance Act, 2019, the first assessment year which is 2019, falls under the old provision, hence, the basis period (1/10/19 – 31/12/19) was treated in assessment year 2019.

The implication of the above revised commencement rule contained in Finance Act, 2019 are:

- Elimination of the complexity surrounding taxation of new companies
- The risk of subjecting profit of a new company to tax twice is eliminated. This implies that overlapping basis period has been eliminated.
- Assessments of new company are now based on prior year accounts (PYB)

4.3.3 **Cessation of trade or business**

With the implementation of Finance Act, 2019 , effective 2020 year of assessment, the assessable profits of a company ceasing to carry on business is the amount of the profits from the beginning of the accounting period to the date of cessation and the tax thereof shall be payable within six months from the date of cessation.

The implication of the revision of cessation rule is that the consideration of penultimate year's assessment is no longer relevant.

"Where a company permanently ceases to carry on a trade or business (or in the case of a company other than a Nigerian company, permanently ceases to carry on a trade or business in Nigeria) in an accounting period, its assessable profits therefrom shall be the amount of the profits from the beginning of the accounting period to the date of cessation and the tax thereof shall be payable within six months from the date of cessation.

Arising from the above, a company that ceased business between January 1 and June 30, will file its returns and pay taxes in that year of cessation, whilst the company that ceased business between July 1 and December 31, will be expected to file returns and pay taxes in the following year.

Illustration 4.4
Apex Nigeria Limited that was incorporated in 1990, ceased operation on March 31, 2020, having been in business for over 25 years. The accounting year-end of the company is December 31, annually.

Required:
Determine the relevant years of assessment and the due dates of payment of tax.

Solution 4.4

YOA	**Basis period**	**Due date of payment of tax**
2020	1/1/19 – 31/12/19	June 30, 2020 (PYB)
2020	1/1/20 – 31/3/20	September 30, 2020 (Six months after the date of cessation)

Illustration 4.5
Given the same scenario stated above, assume the company ceased operation on August 31, 2020.

Solution 4.5

YOA	**Basis period**	**Due date of payment of tax**
2020	1/1/19 – 31/12/19	June 30, 2020 (PYB)
2021	1/1/20 – 31/8/20	February 28, 2021 (Six months after the date of cessation)

4.3.4 Receipts and payments after the date of cessation

Where a company which has permanently ceased to carry on a trade or business subsequently receives or pays any sum which would have been included in or deducted from the profits of that trade or business if it had been received or paid prior to the date of cessation, such sum is treated as having been received or paid on the date of cessation.

Illustration 4.6
Agbadaila Ltd, a once booming enterprise, due to mismanagement of fund went into liquidation on 30/9/17.

The financial returns of the company prior to this date are as follows:-

	₦
Year ended 31/12/14	9,000,000
Year ended 31/12/15	700,000
Year ended 31/12/16	540,000
Period to 30/09/17	360,000

Additional information:

On 1/10/09, the liquidator received ₦20,000.00 written off as bad debt at the end of 2014 accounting year. Also, the liquidator paid the rent due ₦40,000.00 at the end of 2015 accounting year on the same date.

Required:

Compute the assessable profits for all available years of assessment.

Solution to illustration 4.6

Agbadaila Lltd

Computation of assessable profits for 2015, 2016 and 2017 years of assessment

		Assessable profit	
Year of Assessment	Basis Period	₦	₦
2015	1/1/14 -31/12/14		9,000,000
2016	PYB 1/1/15 - 31/12/15	700,000	700,000
2016	AYB 1/1/16 - 31/12/16	540,000	
2017	1/1/17 - 30/09/17		340,000

Workings	₦
Profit adjustment	
Terminal profit (30/9/09)	360,000
Add bad debt recov- ered	20,000
Deduct rent paid	-40,000
Adjusted profit	340,000

4.3.5 Provisions of Finance Act, 2019 on business sold or transferred

With implementation of Finance Act 2019 and effective 2020 year of assessment, where a company is sold or transferred to another related company, there will not be application of commencement and cessation rules.

The Finance Act, 2019, introduced the following:

- Qualifications for exemption from commencement and cessation rules in a business restructuring amongst related parties, require that they should be related for a period of at least one year prior to the restructuring;
- No disposal of assets post restructuring until after one year;
- No Value Added Tax (VAT) and Capital Gains Tax (CGT) on disposal of assets amongst related parties in a business restructuring; and
- Exemption will be withdrawn if disposals are made within one year of restructuring.

4.3.6. Change of accounting date

Change of accounting date occurs when a company that usually prepares accounts to a given date suddenly prepares accounts to another date.
When this happens, the understated procedure/steps shall be adopted by the Federal Inland Revenue Service for the purpose of computing assessable profits of such a company:

Step 1: Identify the first tax year when the change occurred;

Step 2: Identify the next two years following "1" above;

Step 3: Compute assessable profit, on preceding year basis, using the existing accounting date, for the three years stated in '1' and '2' above;

Step 4: Compute assessable profit, on preceding year basis, using the new accounting date, for the three years stated in '1' and '2' above;

Step 5: Add up separately your computations in '3' and '4' above; and

Step 6: Select the higher of your additions in '5' above.

Notes

- The assessable profit selected in step 6 above shall available for tax computation for the three statutory tax years.

- Any tax year before the three statutory tax years shall be assessed to tax on preceding year basis using the old accounting date.

- Any tax year after the three statutory tax year shall be assessed to tax on preceding year basis using the new accounting date.

Illustration 4.7
Bako Adaranijo Ltd gave you the following information in relation to its accounts:

Details		Adjusted profit (₦)
Year ended	30/06/10	400,000
Year ended	30/06/11	520,000
Year ended	30/06/12	600,000
Period to	30/09/13	470,000
Year ended	30/09/14	820,000
Year ended	30/09/15	960,000

Required:

Compute assessable profit for Bako adaranijo Ltd for the three relevant assessment years.

Solution to illustration

4.7 Bako Adaranijo Ltd

Computation of assessable profit

for 2013, 2014 and 2015 years of assessment

	Old date		New date	
Year of assessment	Basis period	Assessable profit (₦)	Basis period	Assessable profit (₦)
2013	1/7/11-30/6/12	600,000	1/10/13-30/9/12	544,000
2014	1/7/12-30/6/13	376,000	1/10/12-30/9/13	376,000
2015	1/7/13-30/6/14	709,000	1/10/13-30/9/14	820,000
		1,685,000		1,740,000

Workings

Profit allocation to basis period

Old accounting date

2013	1/7/11 - 30/6/11	Adjusted profit given	₦600,000
2014	1/7/12 - 30/6/13		
	$\frac{12\text{mths}}{15\text{mths}}$ x N470,000	=	₦376,000
2015	(1/7/13-30/6/14)		₦
i)	[1/7/13-30/9/13] 3mths/15mths x N470,000		94,000

ii)	[1/10/13-30/6/14] 9mths/12mths x N820,000	615,000
		709,000

New Accounting Date:

2013	(1/10/11 - 30/9/12)		₦
i)	(1/10/11 -30/6/12) [9/12 x 600,000]		450,000
ii)	(1/7/12 - 30/9/12) [3/15 x 470,000]		94,000
			₦544,000
2014	(1/10/12 -30/9/13)		₦
	12mths/15mths x 470,000		₦376,000
2015	(1/10/13 - 30/9/14)		
	Adjusted profit given	=	₦820,000

Illustration 4.8

Oke Odo Ltd has been in business for several years. The adjusted profits of the company for the following years are as follows:

		₦
Year ended	31/03/04	500,000
Year ended	31/03/05	400,000
Year ended	31/03/06	300,000
Period to	31/12/06	200,000
Year ended	31/12/07	150,000
Year ended	31/12/08	320,000
Year ended	31/12/09	150,000

Required:

Using a tax rate of 30%, compute the companies income tax liability of Oke odo Ltd., for all the relevant years of assessment.

Solution to illustration

4.8 Oke Odo Ltd

Computation of Tax Liability For 2005 - 2010 years of assessment

Year of assessment	Basis period	Assessable profit ₦	Tax @ 30% ₦
2005	1/4/03-31/3/04	500,000	150,000
2006	1/4/04-31/3/05	400,000	120,000
2007	1/1/06-31/12/06	275,000	82,500

2008	1/1/07-31/12/07	150,000	45,000
2009	1/1/08-31/12/08	320,000	94,000
2010	1/1/09-31/12/09	150,000	45,000

Workings:

(a) Existing Accounting Date

		₦
2007	1/4/05 -31/3/06	300,000
2008	1/4/06-31/3/07	237,500
2009	1/4/07-31/3/08	192,000
		730,000

(b) New Accounting Date

		₦
2007	1/1/06-31/12/06	275,000
2008	1/1/07-31/12/07	150,000
2009	1/1/08-31/12/08	320,000
		745,000

(ci) Existing Date 2008(1/4/06-31/12/06)

	₦
Existing Date 2008(1/4/06-31/12/06)	200,000
(1/1/07-31/3/07) {3/12 x 150,000}	37,500
	237,500

	₦
2009 (1/4/07-31/12/07)(9/12 x 50,000)	112,500
(1/1/08- 31/3/08)(3/12 x 320,000)	80,000
	192,500

(d) New Date

	₦
2007 1/1/06 -31/3/06 {3/12 x 300,000}	75,000
1/4/06 -31/12/06	200,000
	275,000
2008 1/1/07 - 31/12/07 =	₦150,000

4.4 Company income chargeable to tax in Nigeria

Section 8 of the Companies Income Tax Act (CITA) imposes tax at a particular rate (currently 30%) upon the profits of any company accruing in, derived from, brought into, or received in

Nigeria in respect of:

(i) Any trade or business for whatever period of time such trade or business may have been carried on;

(ii) Rent or any premium arising from a right granted to any other person for the use or occupation of any property;

(iii) Dividends, interest, royalties, discounts, charges or annuities;

(iv) Any source of annual profits or gains not falling within the preceding categories. The purpose is to ensure that no taxable profits escape the tax net of the Board; and

(v) Fees, dues and allowances (wherever paid) for services rendered. Any company entering into any agreement (whether oral or written) in respect of any service in this regard is required by the Act to make full disclosure in writing to the Revenue Service of the terms of such agreement (Section 10).

4.5 Dividend income

Tax is imposed on dividend income in Section 8 of CITA. The definition of dividend as given in subsection 3 of Section 8 of the Act is as follows:

(a) In relation to a company not being in the process of being wound up or liquidated, any profits distributed, whether such profits are of a capital nature or not, including an amount equal to the nominal value of bonus shares, debentures or securities awarded to the shareholders; and

(b) In relation to a company that is being wound up or liquidated, any profits distributed, whether in money or money's worth or otherwise, other than those of a capital nature earned before or during the winding up or liquidation. The amount to be taken as the income of a company is the gross amount of the dividend and is deemed to arise on the day on which its payment becomes due. However the provisions of CITA exempt certain dividends from tax.

These are dividends:

(i) By a Nigerian company and satisfied by the issue of shares of the company paying the dividend (bonus shares); or

(ii) By a Nigerian company, out of any profits exempted from tax by any provision of the Act or by the fact that the company enjoys a pioneer status; or

(iii) Out of any profits chargeable to tax under the provisions of the Petroleum Profits Tax Act.

Note that dividends received from a Nigerian company are to be regarded as franked investment income (FII) because the withholding tax deducted on such dividends is treated as the final tax

Also exempts from tax, is dividend derived by a company from another company incorporated in Nigeria provided that the equity participation on which the dividend is payable is:

(a) Either wholly paid for in foreign currency or by asset brought into or imported into Nigeria;

(b) Brought or imported into Nigeria between 1 January 1987 and 31 December 1992; and

(c) Not less than 10% of the equity share capital of the company paying the dividend.

For the purpose of this exemption, the tax free period starting from the year following that in which the new capital is brought into Nigeria shall be five years, if the company is
in the agricultural trade or business, or is engaged in the petrochemicals or liquefied natural gas business. It shall be three years in any other case.

The amount of the withholding tax deducted in connection with any dividend due to a non-resident recipient shall be the final tax on those payments, that is, no further tax is payable by non- resident recipients of any dividend income.

Payment of dividend by a Nigerian company

Nigerian dividends received by companies other than Nigerian companies
In the case of a company which is neither a Nigerian company nor engaged in a trade or business in Nigeria at any time during a year of assessment:

(a) No tax shall be charged for that year in respect of any dividend received by it from a Nigerian company apart from tax withheld under section 80 of this Act;

(b) Where any dividend is paid out of profits on which no tax is payable due to no total profits or total profits which are less than the amount of dividend which is paid, whether the recipient of the dividend is
a Nigerian company or not, the company paying the dividend shall be charged to tax at the rate prescribed in subsection (1) of section 40 of CITA as if such dividend is the total profits of the company for the year of assessment which relates to accounts out of which the dividend is declared;

(c) Nothing in this Act shall confer on such company or on the company paying the dividend, a right to repayment of tax paid by reason of the provisions if this section.

Illustration 4.9
A company with a total profit of ₦140, 000 for 2014 assessment year, paid ₦250,000 dividends to its shareholders in respect of the 2013 financial statements which formed the basis for the assessment.

Solution to illustration 4.9

The company will pay tax of ₦75,000. (30% of ₦250,000 and not ₦42,000 (30% of ₦140,000), assuming that the gross revenue was over 100 million naira. This is what is referred to as excess dividend tax.

4.5.1 Provisions of Finance Act, 2019 on Excess Dividend Tax

Prior to commencement of Finance Act, 2019, companies are charged to tax at 30% on their dividend distributions where such dividends exceed the total profits for the year as illustrated above notwithstanding that profits being distributed may have been taxed in prior years, exempt from tax, or taxed under a different tax law. This particularly affects holding companies on dividends received from their subsidiaries thereby making Nigeria unattractive as a headquarters or group holding company location.

The Finance Act, 2019 introduced changes to limit the application of the tax only to untaxed profits that are not exempt from tax.

The implication of this amendment by Finance Act, 2019 is that the following no longer counts towards determination of excess dividend tax:

- Retained earnings on which adequate tax had previously been paid under CITA, PPTA or the CGTA;
- Exempt profits;
- Franked investment income;
- Dividend by a real estate investment companies (REICO) out of rental and dividend income;
- The year to which the profits relate is also now irrelevant; and
- The possibility of a company paying excess dividend tax is now limited.

4.5.2 Provisions of Finance Act, 2019 on interim dividend paid by companies
Prior to commencement of Finance Act, 2019, companies that paid dividend before filing its annual corporate tax returns shall be subjected to company's income tax at the rate of 30% of the dividend paid and such tax shall be paid to the Federal Inland Revenue Service. The tax paid based on dividend paid, shall be considered as deposit towards tax due from the company.

With implementation of Finance Act, 2019, tax on interim dividend paid to shareholders of a company is no longer applicable.

4.6.1 Interest income

The income from any interest on money lent by an individual, or executor, or a trustee, outside Nigeria to a person in Nigeria (including a person who is resident or present in Nigeria at the time of the loan) shall be deemed to be derived from Nigeria if:

(a) There is a liability to payment in Nigeria of the interest regardless of what form the payment takes and wherever the payment is made;
(b) The interest accrues in Nigeria to a foreign company or person regardless of what form the payment takes and wherever the payment is made.

Interest from a source outside Nigeria

Where an individual is resident in Nigeria, the interest accruing to him from a source outside Nigeria is liable to tax in Nigeria if such amount of interest is brought into or received in Nigeria subject to double taxation provisions, if applicable.

Interest exempted from tax

The following interest incomes are exempted from tax:

(a) Interest on foreign loan in line with Third Schedule of the Companies Income Tax; Act

(b) Interest accruing to a person on foreign currency domiciliary account;

(c) With effect from 1 January 1996, 100% of certain foreign incomes are exempted from tax provided that such incomes are repatriated into Nigeria in convertible currency and paid into a domiciliary account in a bank approved by government. Income falling into this category include interest earned from abroad and brought into Nigeria by a Nigeria resident;

(d) Interest accruing to a person who is not resident in Nigeria as specified below:

(i) the interest on a loan charged on the public revenue of the Federation and raised in the United Kingdom;

(ii) the interest on a bond issued by the Government of the Federation to secure repayment of loan raised from the International Bank for Reconstruction and Development under the authority of the Railway Loan (International Bank) Act;

(iii) the interest on any money borrowed by the Government of the Federation or of a State on terms which include the exemption of interest from tax in the hands of a non- resident person;

(iv) where the Minister of Finance so consents, the interest on any moneys borrowed outside Nigeria by a corporation established by a law in Nigeria upon terms which include the exemption of such interest from tax in the hands of any non-resident person; and

(v) the interest on deposit accounts, provided the deposit into the account are transfers wholly made up of foreign currencies (funds) to Nigeria on or after 1st January 1990 through Government approved channels and the depositor does not become non-resident after making the transfer while in Nigeria;

(e) Interest on any loan granted by a bank on or after 1st Jan. 1997 to a person engaged in:

(i) Agricultural trade or business;

In line with the provisions of Finance Act, 2020, tax relief in respect of interest payable on loans granted to companies engaged in agriculture trade or business now limited to primary agricultural production; and

The Finance Act, 2020 also reduced the moratorium period to qualify the interest on loan for tax exemption from 18 months to 12 months and the rate interest restricted to the base lending rate at the time the loan was granted, refinanced or restructured;

(ii) The fabrication of any local plant and machinery; and

(iii) As working capital for any cottage industry established by the person under the Family Economic Advancement Programme, if the moratorium is not less than 12 months and the rate of interest on the loan is not more than the base lending rate at the time the loan was granted

4.6.2 Provisions of Finance Act, 2019 on exemptions on interest on foreign loans

With commencement of 2019 Finance Act, interest on foreign loans is no longer 100% tax exempt and the Third Schedule to CITA is amended as follows:

Repayment period	**Moratorium**	**Tax exemption allowed**
Above 7 years	Not less than 2 years	**70%**
5 – 7 year	Not less than 18 months	**40%**
2-4 years	Not less than 12 months	**10%**
Below 2 years	**Nil**	**Nil**

4.7 Authorised unit trust scheme

"Unit trust scheme" is defined as "any arrangement made for the purpose of providing facilities for the participation of the public as beneficiaries under a trust in profits or income arising from the acquisition, holding, management or disposal of securities or any other property whatsoever;"

"Authorised unit trust" is defined as "a unit trust scheme that is authorised by the Commission under Section 576 of the Companies and Allied Matters Act 2004(as amended), to carry on the business of dealing in unit trust scheme;"

"Unit holder" is defined as "any investor, beneficiary or person who acquired units in a unit trust scheme and who is entitled to a share of the investments subject to the trusts of a unit trust scheme;"

"A trustee" is defined as "the person in whom the property for the time being subject to any trust created in pursuance of the scheme is or may be invested (vested) in accordance with the terms of the trust.

Income arising to the trustees

The provisions relating to Unit trust schemes as contained in Section 14A of CITA, in respect of the income arising to the trustees of an authorised unit trust, have effect as if:

(i) The trustees were an investment company;

(ii) The rights of the unit holders were shares in the company; and

(iii) Any income accruing to the trustees, available to be paid to the unit holders were dividends on such shares.

The profits of an authorised unit trust scheme, on which tax may be imposed shall be the income accruing to the trustees from all sources of the investment of the unit trust and deducting there from sums disbursed as management expenses, including remuneration for the managers.

The treatment of tax deducted at source is the same as is applicable to any other company taxable under CITA.

4.8 Withholding tax

Withholding tax (WHT) is an advance payment of tax, which is deducted at source on certain transactions and later applied, where it is not a final tax, as tax credit in the settlement of the income tax liability of the year to which the payment that suffered the deduction relates.

Arising from this definition are the following peculiarities of the tax:

(a) Withholding tax is a deduction at source, which gives the taxpayer no option as to whether to pay it, or not;

(b) Withholding tax is an advance payment against the income tax to be paid later. This means that it is not a separate tax;

(c) Withholding tax being an advance payment of income tax cannot be used later as credit for any other tax such as tertiary education tax or value added tax;

(d) Some withholding taxes are regarded as final tax. Where this is so, the income from which they have been deducted can no longer be brought into account for tax purposes;

(e) Withholding tax is to be utilised as credit for the income tax liability of the year to which the income relates in the first instance. Any excess or unutilized credit can be carried forward to future years.

Withholding tax as a collection device was introduced in a limited form by the CITA and later expanded in terms of coverage.

Enabling laws

Sections 68, 69, 70, 71 & 72 of Personal Income Tax Act Cap LFN 2004 (as amended) deal respectively with withholding tax deductions from rent, interest or royalties, dividends and directors fees paid to individuals. On the other hand, sections 78 - 81 CAP 60 LFN 2004 (as amended) deal respectively with deductions from interests, rent and dividends paid to corporate bodies. Sections of PITA and CITA deal with deductions of tax at source in general. It is under these sections that the application of withholding tax could be widened to include building contracts, contract of supplies, consultancy and professional services, which are not specifically mentioned in the CITA.

Withholding tax rates, remittances and tax authorities

Taxes are to be withheld from corporate bodies and individuals at the rate listed in the table below and remitted to the relevant tax authority within 30 days in the case of individuals and 21 days in the case of companies from the date the amount was deducted or from the time the duty to deduct arose, whichever comes up earlier. S. 85 of CITA provides a penalty of 10% per annum and interest at Central Bank rate for failure to remit withholding taxes due to FIRS. S. 74 of PITA provides for a fine of ₦5,000 or 10% of tax due, whichever is higher, in addition to the principal tax due and interest at the bank lending rate for failure to remit the withholding tax due to SBIR.

Table of rates of withholding taxes in Nigeria

Type of payment	Companies rate (F.I.R.S.)	Individual rate (S. B. I. R.)
Royalty	10%	5%
Rents (including hire of Equipment)	10%	10%
Dividends	10%	10%
Interests	10%	10%
Commissions	10%	5%
Consultancy and professional services	10%	5%
Technical services	10%	5%
Management services	10%	5%
Directors fees	-	10%
Construction	2.5% or 5%	2.5% or 5%
Contract supplies	5%	5%

Comments:

(a) The deduction from companies are payable to the FIRS.

(b) The deduction from individuals and enterprises are payable to the SBIR on the basis of residence.

(c) The deductions from individuals are payable to the FIRS or FCT IRS, when they are made from residents of the FCT, Abuja, members of the Nigerian Armed Forces and Police, Officers of the Nigerian Foreign Service and persons resident outside Nigeria who derive income from Nigeria. Withholding taxes on dividend, interest, rent and royalties when suffered by non-residents are final taxes. Also, with effect from January 1996, withholding tax on interest and dividend are final taxes when suffered by Nigerians.

Provisions of Finance Act, 2019 on withholding tax rates on construction activities

Section 81 of CITA (i.e. deduction of tax at source) was amended by Finance Act, 2019 to reduce withholding tax (WHT) rate to 2.5% for the following construction activities:

- Roads;
- Bridges;
- Buildings; and
- Power Plants.

The implementation of this amendment will likely address the frequency of WHT refund claims by construction companies.

Credit notes

As soon as payment is made to the bank and evidence provided to the FIRS, the withholding tax section of the FIRS is required to issue credit notes in favour of the beneficiaries (taxpayers) contained in the schedule. The credit notes are to be forwarded by the collection agent to the beneficiaries who suffered the deductions. This is because the credit notes are to be used in claiming tax credits at the various tax offices where their files are domiciled. It is important to emphasise that the presentation of a letter from the collector agent showing that a taxpayer has suffered deductions is not enough for the FIRS to give credit.

Similarly, Government treasury receipts issued by other government departments showing that they have deducted tax from a taxpayer is not enough to grant tax credit since only the FIRS can collect income tax for the federal government, while only the SIRS can collect tax for the States.

Withholding VAT deduction

All government agencies, ministries and department and companies operating in the oil and gas sector are required to:

(a) Act as agents in the deduction of withholding tax from contract sums payable to their contractors; and

(b) Also act as agents in the collection of VAT from their contractors when such contractors are paid. This is often referred to as withholding VAT.

Advance income tax payment

When a company wishes to pay dividend, CITA Section 31(7) provides that tax at standard company tax rate is payable on the amount of the dividend. The provisions of Sections 15A and 16(B) of CITA also have the same effect.

If any provisional tax has been paid by the company for the assessment year, this will be taken into account in determining the amount of tax payable under this section. The tax is payable before the dividend is paid and has nothing to do with withholding tax which will still be deducted normally.

The tax so paid will be taken as a deposit against the tax due from the company on the profits out of which the dividend is paid.

Thus, when the company wishes to settle its tax liability, the amount paid as deposit will be deducted from the total amount of the income tax liability of the company for that year.

Illustration 4.10

A company is paying a dividend amounting to ₦500,000 in respect of the year ended December 31, 2013, payable on June 15, 2014. The total profit of the company for the year was ₦800,000 after capital allowances. The company intends to file its self assessment by the due date of June 30, 2014.

Solution to illustration 4.10

Under this situation, the company will need to pay a tax of ₦150,000 (30% of ₦500,000) prior to the payment of the dividend. Thereafter, the dividend of ₦500,000 can be paid subject to deduction of applicable withholding tax.

When the company is assessed to tax, its tax liability will be as follows:

	₦
Total profit	800,000
Income tax at 30% thereon	240,000
Less tax paid in advance	(150,000)
Balance of tax payable	90,000

Note:

Under the self assessment scheme, companies are not expected to wait to receive assessments from the Revenue before settling their respective tax liabilities.

4.9 Exemption of sales in the ordinary course of business from withholding tax

On November 30, 2020, the Tax Appeal Tribunal (TAT), Lagos Zone, in the case of Tetra Pak West Africa Limited vs Federal Inland Revenue Service, ruled that sales in the ordinary course of business shall not be liable to withholding tax (WHT).

The TAT laid the following criteria in ascertaining what constitutes "sales in the ordinary course of business";

(a) The inclusion of the transaction/activity in the objects of the memorandum of associations;

(b) The nature and practice of the taxpayer's business and industry;

(c) The history of the taxpayer in relation to the activity, and

(d) The frequency of the type of transaction.

4.10 The profits of a Nigerian company (CITA Section 11)

The profits of a Nigerian company shall be deemed to accrue in Nigeria wherever they have arisen and irrespective of their being brought into or received in Nigeria. "The profits of a company, other than a Nigerian company from any trade or business shall be deemed to be derived from Nigeria:

(a) If that company has a fixed base of business in Nigeria, to the extent that the profit is attributable to the fixed base;

(b) If it does not have such a fixed base in Nigeria but habitually operates a trade or business through a person in Nigeria authorized to conclude contracts on its behalf or on behalf of some other companies controlled by it or which have controlling interest in it; or habitually maintains a stock of goods or merchandise in Nigeria from which deliveries are regularly made by a person on behalf of business or trade or activities carried on through that person;

(c) If that trade or business or activity, involves a single contract for surveys, deliveries, installation or construction, the profit from that contract; and

(d) Where the trade or business or activity is between the company and another person controlled by it or which has controlling interest in it and conditions are made or imposed between the company and such person in their commercial or financial relations, which, in the opinion of the Revenue Service, is deemed to be artificial or fictitious, so much of the profits adjusted by the Revenue Service to reflect arm's length transaction" (Subsection 2).

For the purposes of subsection (2)(a) of this Section, a fixed base shall not include:

(i) Facilities used solely for storage or display of goods or merchandise; and

(ii) Facilities used solely for the collection of information.

4.11 Other profits or gains exempted from companies income tax

Section 19 of CITA contains the list of profits or gains of companies or corporate bodies exempted from company taxation:

(a) Profits or incomes exempted in so far as they are not derived from trade or business being carried on:

(i) The profits of any company being a statutory or registered friendly society;

(ii) The profits of any company engaged in ecclesiastical, charitable or educational activities of a public character; in line with the provisions of the Finance Act, 2020, public character for the purpose of tax exemption requires an organisation or institution to be registered in accordance with relevant laws in Nigeria and does not distribute or share its profits in any manner to members or promoters.

(iii) The profits of any company being a trade union, registered under the Trade Unions Act;

(iv) The profits of any company or corporation established by the law of a State for the purpose of fostering the economic development of that State;

(v) The profits of any company being a cooperative society, registered under any enactment or law relating to cooperative societies not being profits from any trade or business carried on by that company other than cooperative activities solely carried out with its members or from any share or other interest possessed by that company in a trade or business in Nigeria carried on by some other person or authority. If any income in respect of the foregoing is derived from a trade or business, it is clear from the wordings of Section 19 that such shall become taxable.

(b) The following are also exempted from tax:

(i) The profits of any company formed for the purposes of promoting sporting activities where such profits are wholly expendable for such purpose, subject to such conditions as the Revenue Service may prescribe;

(ii) Dividend distributed by a unit trust;

(iii) Dividend derived by a company from another company incorporated in Nigeria, provided that:

- The equity participation of the recipient of the dividend in the company paying the dividend is either wholly paid for in foreign currency or by assets brought or imported into Nigeria between 1 January, 1987 and 31 December, 1992; and

- The company receiving the dividend is the beneficial owner of not less than 10% of the equity share capital of the company paying the dividend. The dividend tax-free period shall commence from the year of assessment following the year in which the new capital is brought into Nigeria for the purpose of the trade or business in Nigeria of the company paying the dividend. If the company paying the dividend is in the agricultural trade or business, or is engaged in the petrochemicals or liquefied natural gas, the tax-free period shall be five years, while in any other case it is limited to three years.

(iv) The profits of any company engaged in petroleum operations within the meaning of Section 2 of the Petroleum Profits Tax Act in so far as those profits are derived from such operations and liable to tax under that Act. It should be noted that if any part of the profits of such company arises from other operations besides petroleum exploration, development and production and can therefore not be taxed under the Petroleum Profits Tax Act, such part is taxable under the Companies Income Tax Act;

(v) The profits of any company being a body corporate established by or under any Local Government Law or Edict in force in any State in Nigeria;

(vi) The profits of anybody corporate being a purchasing authority established by an enactment and empowered to acquire any commodity, for export from Nigeria as well as from the purchase and sale of that commodity;

(vii) The profits of non-Nigerian companies which, but for this paragraph, would be chargeable to tax by reason solely of their being brought into or received in Nigeria; and

(viii) Dividend, interest, rent or royalty derived by a company from a country outside Nigeria and brought into Nigeria through government approved channels. "Government approved channels" means the Central Bank of Nigeria, any bank or other corporate body appointed by the Minister as authorised dealer under the Second-Tier Foreign Exchange Market Act or any enactment replacing that Act.

(ix) The interest on deposit accounts of a foreign non-resident company; provided that the deposits into the account are transfers wholly of foreign currencies to Nigeria on or after 1 January 1990, through Government approved channels;

(x) The interest on foreign currency domiciliary account in Nigeria accruing on or after 1 January 1990;

(xi) Profits of a small company in a relevant assessment year provided;

- Such company shall without prejudice to this exemption, comply with the tax registration and tax return filing stipulations of this Act and be subject to the provisions as regards time of filing, penalties for breach of statutory duties and all other provisions of this Act in all respects during the period which its profits are below the tax paying threshold; or

- They are dividends received from small companies in the manufacturing sector in the first five years of their operations.

(xii) Dividend received from investments in wholly export-oriented businesses;

(xiii) Profits of a Nigerian company in respect of goods exported from Nigeria if the proceeds of such exports are used for the purchase of raw materials, plant, equipment and spare parts; provided that tax shall accrue proportionately on the portion of such proceeds which are not utilised in the manner prescribed.

(xiv) The profits of a company whose supplies are exclusively inputs to the manufacturing of products for export, provided, that the exporter shall give a certificate of purchase of the inputs of the exportable goods to the seller of the supplies.

(xv) The dividend and rental income received by a real estate investment company on behalf of its shareholders provided that;

- A minimum of 75% of the dividend and rental income is distributed; and
- Such distribution is made within 12 months of the end of the financial year in which the dividend or rental income was earned;

(xvi) The compensating payments, which qualify as dividends under section 9 (1) (c) of this Act, received by a lender from its approved agent or a borrower in a regulated securities lending transaction, such payments are deemed to be franked investment income and shall not be subjected to further tax in the hands of the lender; and

(xvii) The compensating payments which qualify as dividends or interest under section 9(1)(c) of this Act, received by an approved agent from a borrower or lender on behalf of a lender or borrower in a regulated securities lending transaction.

In respect of all the foregoing, appropriate withholding taxes are deductible in accordance with the provisions of Sections 60, 61, 62 of CITA in spite of the fact of the exemptions of the gains or profits from income tax.

The National Council of Ministers (Federal Executive Council) may exempt order:

i. Any company or class of companies from all or any of the provision of the Act; or

ii. All or any profits of any company or class of companies from any source, on any ground which appears to it sufficient.

The National Council of Ministers may by order amend, add to or repeal any exemption, in so far as it affects a company.

The following notices and order shall continue in force for all purposes of the Act:

(a) The Income Exemption (interest on Nigerian Public Loans) Notice;

(b) The Income Tax Exemption (Nigerian Broadcasting Corporation) order; and

(c) The Railway Loan (International Bank) (Exemption of Interest) Notice.

Interest on loans – Agricultural trade and others

Interest on loan granted by bank for primary agricultural production shall be exempted from tax if at least twelve months moratorium is allowed and the rate of interest is not more than the base lending rate of the bank at the time the loan was granted, refinanced or otherwise restructured. Primary agricultural production is defined as:

(a) Primary crop production comprising the production of raw crops of all kinds, but excluding any intermediate or final processing of crops or any other associated manufactured or derivative crop products;

(b) Primary livestock production comprising the production of live animals and their direct produce such as live or raw meat, live or raw poultry, fresh eggs and milk of all kinds, but excluding any other associated manufactured or derivative livestock products;

(c) Primary forestry production comprising the production of timbers of various kinds such as firewood, charcoal, uncultivated materials gathered and other forestry products of all kinds, including seeds and samplings, but excluding the intermediate and final processing of timber and any other manufactured or derivative timber products; and

(d) Primary fishing production comprising the production of fish of all kinds, including ornamental fish, but excluding any intermediate or final processing of any other manufactured or derivative fish products.

Act 18 of 1998

Subsection 7 of Section 9 of the Act has been replaced with a new subsection 7 in Act 18 of 1998. The new subsection 7 is as follows:

Interest on any loan granted by a bank on or after 1 January 1997 to a company

(a) Engaged in –
   (i) Agricultural trade or business, or
   (ii) The fabrication of any local plant and machinery; or

(b) As working capital for any cottage industry established by the company under the Family Economic Advancement Programme (FEAP), shall be exempted from tax, provided:
   (i) The moratorium is not less than twelve months; and
   (ii) The rate of interest on the loan is not more than the base lending rate at the time the loan was granted, refinanced or otherwise restructured." Thus, the provisions relating to the loans granted to agricultural trade or business on or after January 1, 1991, are extended to the trade or fabrication of local plant and machinery as well as Family Economic Advancement Programme (FEAP) cottage industry with effect from January 1, 1997.

Interest on loan for export business

Interest accruing from loans granted by banks in aid of export activities is exempted from tax in accordance with the Table in Schedule 3 to the Act.

4.12 Provisions of Finance Act, 2019 on tax exemption of interest on foreign loans

With commencement of Finance Act, 2019, interest on foreign loans is no longer 100% tax exempt and the Third Schedule to CITA has been amended as follows:

Repayment period Including moratorium	**Grace period**	**% Tax exemption allowed**
(i) Above 7 years	Not less than 2 years	70%
(ii) 5-7 years	Not less than 18 months	40%
(iii) 2-4 years	Not less than 12 months	10%
(iv) Below 2 years	Nil	Nil

4.13 Ascertainment of the end of the first accounting period

The ascertainment of the end of the first accounting period is key in the determination of basis period and the first year of assessment.

The first accounting period begins from the date of commencement of business to the end of its first accounting year-end.

In a situation where a company prepares the audited financial statements for a period shorter or longer than the first accounting period, the assessable profits for the first accounting year will be determined on pro-rata basis.

4.14 Provisions of Finance Act, 2019 on classification of companies and rates of tax

The position of Companies Income Tax Act (CITA) prior to commencement of Finance Act, 2019 is that all Nigerian companies are liable to the same Companies Income Tax (CIT) rate of 30% as stated above with exception of small businesses whose turnover does not exceed N1,000,000 that are taxed at reduced rate of 20%.

The Finance Act, 2019 has classified companies into various categories and tax rates are as follows:

Types of companies	**Basis of classification**	Applicable tax rate
Small companies	Annual gross turnover of N25,000,000 or less	0%
Medium-sized companies	Annual gross turnover of greater than ₦25,000,000 but less than N100,000,000	20%
Large companies	Annual turnover of N100,000,000 and above	30%

Implication of classification of Nigerian companies

These include but not limited to:

- Small businesses are still required to register for tax, prepare audited financial statements and file tax returns as and when due; and
- Small companies are no longer liable to Withholding Tax (WHT) on their income since WHT is an advance payment of companies income tax.

4.15 Chapter review

This chapter provides a detailed explanation of the various investment incomes including, dividend, interest, rent and royalty. It also highlights investment incomes that are exempted from tax.

Readers must have known those incomes chargeable/exempted to/from Nigerian tax, the readers must have learnt how the Finance Acts, 2019 & 2020 affected the taxation of companies in Nigeria.

4.16 Worked examples

4.16.1 Open-ended Questions

(1) Change of accounting date is a day- to- day business experience.

Required:
Explain the procedure for computing assessable profit of a company when there is a change of accounting date.

(2) Nigerian tax system consists of various incentives to encourage production in the real sector.

Required:
Explain the incentives associated with loans and advances granted by banks to companies engaged in primary agricultural production.

(3) Orion Limited was incorporated in December 2018 and commenced business on October 1, 2019. The first set of financial statements prepared by the company covered a period of 15 months, that is October 1, 2019 to December 31, 2020 and the adjusted profit was ₦3,000,000.

Required:
Ascertain the relevant basis periods and the assessable profits for the relevant assessment years.

4.16.2 Suggested solutions to open-ended Questions

(1) Change of accounting date occurs when a company that usually prepares accounts to a given date suddenly prepares accounts to another date. When this happens, the understated procedure/steps shall be adopted by the Federal Inland Revenue Service for the purpose of computing assessable profits of such a company:

Step 1: Identify the first tax year when the change occurred;
Step 2: Identify the next two years following "1" above;
Step 3: Compute assessable profit, on preceding year basis, using the existing accounting date, for the three years stated in '1' and '2' above;
Step 4: Compute assessable profit on preceding year basis, using the new accounting date, for the three years stated in '1' and '2' above;
Step 5: Add up separately your computations in '3' and '4' above; and
Step 6: Select the higher of your additions in '5' above.

(2) Interest on loan granted by bank for primary agricultural production shall be exempted from tax, if at least twelve months moratorium is allowed and the rate of interest is not more than the base lending rate of the bank at the time the loan was granted, refinanced or otherwise restructured. Primary agricultural production is defined as:

(a) Primary crop production comprising the production of raw crops of all kinds, but excluding any intermediate or final processing of crops or any other associated manufactured or derivative crop products;

(b) Primary livestock production comprising the production of live animals and their direct produce such as live or raw meat, live or raw poultry, fresh eggs and milk of all kinds, but excluding any other associated manufactured or derivative livestock products;

(c) Primary forestry production comprising the production of timbers of various kinds such as firewood, charcoal, uncultivated materials gathered and other forestry products of all kinds, including seeds and samplings, but excluding the intermediate and final processing of timber and any other manufactured or derivative timber products; and

(d) Primary fishing production comprising the production of fish of all kinds, including ornamental fish, but excluding any intermediate or final processing of any other manufactured or derivative fish products.

Solution 3

Orion Limited
Ascertainment of the relevant basis periods and assessable profits for the relevant assessment years

YOA	Basis period	Assessable profit
		N
2019	1/10/19 – 31/12/19	600,000
2020	-	0
2021	1/1/20 – 31/12/20	2,400,000
		3,000,000

Arising from the above, the company did not have any assessable profit for A.Y. 2020, hence it will not pay companies income tax.

Given the provisions of the Finance Act, 2019, the first assessment year which is 2019, falls under the old provision, hence, the basis period (1/10/19 – 31/12/19) was treated in assessment year 2019.

5

Ascertainment of adjusted profit

Content

1 Ascertainment of adjusted profit

5.0 Purpose

After studying this chapter, readers should be able to:

(h) Know the reasons why business profits may not be acceptable directly for the computation of companies income tax;

(i) Know those expenditure items allowable as deductions from business income for tax purposes;

(j) Know those expenditure items not acceptable as deductions from business income for tax purposes;

(k) Know the types of donations allowable as deductions from business income in the ascertainment of adjusted profit;

(l) Know amendments made to allowable and disallowable expenses by Finance Acts, 2019 and 2020; and

(m) Know the procedure for the computation of adjusted/assessable profit.

5.1 Introduction

For tax purposes, use is made of the accounts produced under the ordinary rules of accountancy, as it will be extremely difficult, if not impossible, to prepare new sets of accounts for tax purposes only. Besides the difficulties anticipated, there appears to be no justification for the unnecessary duplication of the efforts that would be required in the production of such accounts. It has been established in some decided cases, that in ascertaining the true profits of a trade for tax purposes, regard should be paid to the correct principles of accountancy. Thus, in practice, adjustments that are considered necessary in view of the provisions of the Tax Acts, are made to accounting profits, to arrive at the profits for tax purposes. Such adjustments are usually in respect of:

(a) Expenditure charged but not allowable – disallowable expenditure;

(b) Items chargeable to tax but not credited in the statement of profit or loss (SPL);

(c) Items credited in the SPL but not taxable; and

(d) Expenditure not charged but allowable.

There are adequate provisions in the Act which when considered in the light of normal taxation practice, can be applied to determine which items of a company's trading transactions will fall into any of the four categories listed above and for which adjustments will be necessary. The main guiding principle is that of allowable and disallowable expenditure.

5.2 Allowable deductions

All expenses of a company that are wholly, exclusively, necessarily, and reasonably incurred in the production of the profits, are allowable deductions. Thus, any expense that can be proved to meet these conditions will be an allowable deduction in arriving at a company's chargeable profit unless such expense is specifically prohibited under any other provision of the Act.

In addition, the following items are stated in Section 20 of the Act, as allowable deductions provided they are incurred for the purpose of acquiring the profits being subjected to tax:

(a) Subject to the provisions of seventh Schedule to this Act, any sum payable by way of interest on debt borrowed and employed as capital in acquiring the profits of a company;

(b) Rent and premiums in respect of land or buildings occupied for the purpose of acquiring the profits;

(c) Repairs and renewal costs relating to the premises, plant, fixtures, etc., used in the business;

(d) Bad and doubtful debts to the extent that they are respectively estimated to the satisfaction of the Revenue Service to have become bad or doubtful of collection;

(e) Contributions to approved pension, provident or other retirement benefits fund, society or scheme;

(f) In the case of the Nigerian Railway Corporation, such deductions as are allowed under the provisions of the authorised deductions, (Nigerian Railway Corporation) Rules, 1959, which rules shall continue in force for all purposes of this Act;

(g) Any outlay or expenses incurred during the year in respect of:

(i) Salaries, wages or other remuneration paid to employees; and

(ii) Cost to the company of any benefit or allowance provided for the senior staff and executives which shall not exceed the limit of the amount prescribed by the collective agreement between the company and the employees and approved by the Federal Ministry of Employment, Labour and Productivity and the Productivity, Prices and Income Revenue Service as the case may be;

(h) The expenses proved to the satisfaction of the Revenue Service to have been incurred by the company on research and development for the period including the amount of levy paid by it to the National Science and Technology Fund.

(i) Section 22 allows for the deduction of the amount of reserve made out of profits for research and development subject to a ceiling of 10% of the total profits of the company before any deduction is made under this Section and Section 21 of the Act;

(j) Companies and other organisations engaged in research and development activities for commercialisation shall be allowed 20% investment tax credit on their qualifying expenditure for that purpose;

(k) Such other deductions as may be prescribed by the Minister by any rule;

(l) Dividends or mandatory distributions made by a real estate investment company duly approved by the Securities and Exchange Commission to its shareholders;

(m) Compensating payments which qualify as interest under the Act made a lender to its approved agent or a borrower in a regulated securities lending transaction; and

(n) In the case of profits from a trade or business, any expenses or part thereof:

- The liability for which was incurred during that period wholly, exclusively, necessarily and reasonably for the purposes of such trade or business and which is not specifically referable to any other period or periods; or

- The liability for which was incurred during any previous period wholly, exclusively, necessarily and reasonably for the purpose of such trade or business and which is specifically referable to the period of which the profits are being ascertained; and

- The expenses proved to the satisfaction of the Service to have been incurred by the company on research and development for the period including the amount of levy paid by it to the National Science and Technology Fund.

Rental charges

Rental charges in respect of residential accommodation occupied by employees of the company are allowed up to a maximum of 100% of the basic salary of employees.

Repairs and renewals

The usual items under this heading are those expenses incurred in maintaining the earnings capacity of the assets of the company intact. In view of the fact that the keeping of such assets in good working condition is very essential for the company to acquire profits, costs connected with such exercise must, by reasonable expectation, be allowable deductions.

However, costs incurred in increasing the earning capacity of any fixed asset are capital in nature and therefore will not be allowable deductions. Repair expenditure on newly acquired fixed assets might not qualify as an allowable deduction particularly if large amount is involved and the expenditure is incurred to bring the asset into a usable condition after its acquisition. Such cost is to be considered as capital and should be added to the cost of acquisition of the asset. It is important to take note that repair costs are incurred for the purpose of maintaining the earning capacity of the asset and this implies that such asset must be in use in the business at the time that the repair work is carried out.

Bad and doubtful debts

The salient matters to note with regard to the treatment of bad and doubtful debts for tax purposes are as follows:

(a) They must relate to debts incurred in the ordinary course of the trade or business;

(b) They must be identifiable to specific debts. General reserves against bad and doubtful debts are not allowable deductions;

(c) Reserves no longer required are taxable (in the year that they are considered no longer necessary) if previously allowed;

(d) Debts previously written off, allowed in tax computation, and later recovered are taxable as income for the year in which recoveries are made; and

(e) Necessary evidence must be provided at the request of the Revenue Service to prove that the debts have become bad or estimated to be doubtful of recovery.

Illustration 5.1

The bad and doubtful debts account of a company for a year showed the following:

	₦		₦
Trade debts written off	13,000	Reserves b/f:	
Reserves c/f:		Specific	20,000
Specific	22,000	General	16,000
General	15,000	Charged to P or L A/C	14,000
	50,000		50,000

In the statement of profit or loss of this company, the sum of ₦14,000 will be shown as the charge for bad and doubtful debts for the year. How this sum has been arrived at can be reproduced in a statement form as follows:

		₦
Trade debts written off	(a)	13,000
Add: Increase in specific provision (₦22,000 – ₦20,000)	(b)	2,000
		15,000
Less: Reduction in general provision (N16,000 –N15,000)	(c)	(1,000)
Charged in statement of profit or loss		14,000

It will be easier from this statement to determine which amount should be adjusted for, in the tax computation in respect of this company's bad and doubtful debts charge, as follows:

(a) This will be an allowable charge as the amount written off is in respect of specific debts;

(b) The increase will also be allowable as the amount involved is also in respect of specific debts; and

(c) The general provision would have previously been disallowed when created. Any subsequent release of this sort of provision cannot be taxable as it had never been allowed. Thus, the accounting profit will be reduced by the amount of the reduction in the general provision, resulting in a lower taxable profit than the accounting profit.

The only adjustment necessary in respect of the foregoing is a deduction of the sum of ₦1,000 in respect of (c) above from the accounting profit to arrive at the taxable profit of the company.

Thus, if a specific reserve for bad debts increases or decreases, no adjustment is necessary to the accounting profit, but in case of general reserve appropriate adjustment will need to be put through.

Illustration 5.2

The analysis of the bad debt provision account of Chukwu Limited showed the following as at 31/12/17:

	₦
General provision for doubtful debt c/f	35,000
Specific provision for doubtful debt c/f	48,000
Bad debt written off	70,000
Loan to customer written off	22,500
General provision for doubtful debt b/f	(15,000)
Specific provision for doubtful debt b/f	(18,000)
Bad debt written off recovered	(59,000)
Statement of profit or loss	83,500
	=======

The amount N83,500 has been charged in the accounts for the year ended 31/12/17

Required:

Reconcile the account for tax profit adjustment purposes.

Suggested solution to illustration 5.2

Chukwu Limited

Bad debt reconciliation account

	₦		₦
Bad debt written off	70,000	Bal b/f	18,000
		Bad debt recovered	59,000
Bal c/d (Specific provision)	48,000	Stat. of profit or loss	41,000
	118,000		118,000
	======		======
		Bal c/f	48,000

Amount of provision to be made before arriving at the adjusted profit:

	₦
Amount charged in the account	83,500
Less adjustment from bad debt provision account	(41,000)
Amount to be added back	42,500

Donations

CITA Section 21 stipulates, among other things, the conditions to be satisfied before any donation can be allowed. These are:

(a) Donations must be made out of the profits of the company (Section 21(2). Thus if a company makes a loss, whatever donations paid during that year should not be treated as allowable;
(b) Donations should not be expenditure of a capital nature;
(c) For any year of assessment, the maximum amount allowable is limited to 10% of the total profits of the company before deducting the donations; and
(d) The donation must be made to any of the approved bodies.

Note
Following the provisions of the Companies Income Tax (Amendment) Act 2007, donations (whether of a revenue or Capital nature) made in respect of university and other tertiary or research institutions for research or any developmental purpose, or as an endowment out of profits of the period by a company, shall not exceed an amount which is equal to 15% of the total profits or 25% of the tax payable in the year of the donation, whichever is higher.

5.2.1 Provisions of Finance Act, 2020 on donations

Donations made by companies in cash or kind to any fund set up by the Federal Government or any State Government, or to any agency designated by the Federal Government or to any similar Fund or purpose in consultation with any Ministry, department or agency of the Federal Government, in respect of any pandemic, natural disaster or other exigency shall be allowed as deductions as follows:

(a) The cost of in-kind donations made to the Government and any designated agency shall be allowed as deductions; or

(b) Where companies have either procured or manufactured items for contribution, the cost of purchase, manufacture or supply of such in-kind contributions shall be allowed as deductions.
However, the requisite documentation evidencing the donation and the cost thereof are provided to the relevant tax authority and demonstrated to be wholly, reasonably, exclusively and necessarily incurred in relation to the procurement, manufacture or supply of the in-kind contributions.
Meanwhile, the amounts allowable for deduction, in respect of this donation in any year of assessment shall be limited to 10% of assessable profits after deduction of other allowable donations made by the company.

Fifth schedule (section 21)

The funds, bodies and institutions in Nigeria to which donations may be made under section 21 of the Act are:

Youths/philanthropic organisations

(a) The Boys Brigade of Nigeria

(b) The Boys Scouts of Nigeria

(c) The Girls Guides of Nigeria

(d) The Nigerian Red Cross

(e) The National Youth Council of Nigeria

(f) The Nigerian Youth Trust

Religious

(a) The Christian Council of Nigeria

(c) Islamic Education Trust

Medical

Any hospital owned by the government of the federation or of a state or any university teaching hospital or any hospital which is carried on by a society or association otherwise than for the purpose of profits or gains, to the individual members of that society or association.

Educational

(a) Any educational institution affiliated under any law with any University in Nigeria or established under any law in Nigeria and any other educational institution recognised by any Government in Nigeria

(b) The Institute of Medical Laboratory Technology

(c) The National Library

(d) A public fund established and maintained exclusively for providing money for the acquisition, construction, maintenance or equipping a building used or to be used as a school or college by the Government of the Federation or a state or by a public authority or
by a society or association which is carried on otherwise than for the purpose of profit or gain to the individual members of that society or association.

(e) The National Braille Library of Nigeria

(f) Van Leer Nigerian Educational Trust

(g) The Institute of Chartered Accountants of Nigeria Building Fund

(h) Nigerian Accounting Standards Revenue Service

(i) Paterson Zochonis Nigeria Technical Education Trust Fund

(j) Educational Cooperative Society

Relief funds

(a) National Commission for Rehabilitation

(b) A public fund established and maintained for providing money for the construction or maintenance of a public memorial relating to the civil war in Nigeria which ended on

January 15, 1970.

(c) Southern Africa Relief Fund

(d) Any public fund established or approved by the government of the federation or any of the state governments in aid of or for the relief of drought or any other national disaster in any part of the federation

Research

(a) The Cocoa Research Institute of Nigeria

(b) The National Council for Medical Research

(c) The National Science and Technology Development Agency

(d) The Nigerian Institute for International Affairs

(e) The Nigerian Institute for Oil Palm Research

(f) The Nigerian Institute for Trypanosomias is Research

(g) National Science and Technology Fund.

Welfare

(a) A public institution or public fund (including the Armed Forces Comfort Fund) established or maintained for the comfort, recreation or welfare of members of the Nigerian Army, Navy or Air Force

(b) National Sports Commission and its State Associations

(c) The Nigerian Society for the Deaf and Dumb

(d) The Society for the Blind

(e) The Nigerian National Advisory Council for the Blind

(f) Associations or Societies for the Blind in Nigeria

(g) Training Centres and Residential Schools for the Blind in Nigeria

(h) Rotary International (Polioplus programme)

(i) The Musical Society of Nigeria.

Foundations/endowment fund

(a) Kewalram Chanrai Foundation Limited

(b) Afprint Foundation Limited

(c) University College Hospital Endowment Fund

Others

(a) The Nigerian Museum

(b) Nigerian Conservation Fund

References to donations made by a company do not include any payments made by the company for valuable consideration.

Research and development

The basis for allowing the amounts relating to research and development are in two sections of the Act.

Section 20(g) (iii)

This section allows expenses proved to the satisfaction of the Revenue Service to have been incurred by the company on research and development for the period including the amount of levy paid by it to the National Science and Technology Fund.

Section 22

This section allows the deduction of amount of reserves made out of the profits of that period by a company for research and development. The deduction to be allowed under this Section for any year of assessment shall not exceed 10% of the total profits of the company for that year as ascertained before any deduction is made under this Section and Section 21 (deductible donations) of the Act.

The effect of these two sections can be summarised thus:

(a) Actual expenditure on research and development are allowable deductions in accordance with the provisions of Section 20; and

(b) Reserve made out of profits for research and development expenditure are allowed as a deduction from profit subject to the ceiling fixed.

One thing to be noted though is that a company cannot make the deduction twice. If the deduction was made when the reserve was made, such cannot be deducted again when the actual expenditure is incurred.

In addition, subsection 3 of Section 22 provides for 20% investment tax credit on the qualifying expenditure of companies and other organisations engaged in research and development activities for commercialisation once the expenditure are incurred for that purpose.

5.3 Disallowable expenditure

Certain expenditure are disallowed for tax purposes. These are specifically listed in Section 23 of the Act and they should be added back to accounting profit even if their charge in the statement of profit or loss could be justified under ordinary rules of commercial accountancy. These are:

(a) Capital repaid or withdrawn and any expenditure of a capital nature;
(b) Any sum recoverable under an insurance or contract of indemnity;
(c) Taxes on income or profits levied in Nigeria or elsewhere. In case of tax levied outside Nigeria on profits which are also chargeable to tax in Nigeria and double taxation relief is not available, such tax will be an allowable deduction;
(d) Payments to unapproved pension, provident, savings or widows and orphans society, fund or schemes;
(e) Depreciation of any asset; (capital allowances are granted instead);

(f) All appropriations for profit; namely, dividends; general provision for bad and doubtful debts; write off of preliminary and formation expenses and expenses on issue or redemption of shares and other securities, etc.; Pre-production expenses to the extent to which they are not of capital nature will be allowable deduction as such have been incurred for the purpose of producing the company's profit;

(g) Any expense whatsoever incurred within or outside Nigeria involving related parties as defined under the transfer pricing regulations, except to the extent that it is consistent with the transfer pricing regulations;

(h) Any expense incurred in deriving tax exempt income, losses of capital nature and any expenses allowed as a deduction under Capital Gains Tax Act for the purpose of determining chargeable gains;

(i) Any compensating payment made by a borrower which qualifies as dividends under the Act to its approved agent or to a lender in a regulated securities exchange rransaction;

(j) Any compensating payment made by an approved agent which qualifies as interest or dividends under the Act to a borrower or lender in a regulated securities exchange transaction;

(k) Any penalty imposed by any Act of the National or State House Assembly for violation of any statute; and

(l) Any tax or penalty borne by a company on behalf of another person.

5.4 Waiver or refund of liability or expense

Where the liability for an allowed expense is subsequently waived or released or a refund is received for the amount paid, the amount which is so waived, released, or refunded is deemed to be the income of the company in the year in which the waiver, release or a refund is made or given. Similar provision is applicable in personal taxation practice.

It should be noted that where a waiver of a non-revenue item, for example, a loan is in favour of a company, such an amount should be subjected to capital gains tax (CGT) if applicable, NOT companies income tax, as the liability had not been previously treated as an allowed expense.

5.5 Format/demonstration of adjustment of accounting profit

The taxpayer is expected to file his financial statement with the Federal Inland Revenue Service on annual basis. Included is the statement of the financial position for the year just ended. The income statement is limited to the understanding of the taxpayer. Therefore, as stated earlier:

- Some income chargeable might have been omitted e.g. investment income, undisclosed revenue, etc.;
- Some income not chargeable might have been included e.g. franked investment Income [dividend], profit on disposal of company's assets/investments etc.;
- Some expenses allowable as deductions might have been omitted due to errors, or mistakes;
- Some expenses not allowable as deductions might have been deducted e.g. expenses not wholly, exclusively, reasonably or necessarily incurred for the purpose of the particular business / company.

Therefore, there is a need to adjust for these shortcomings before tax liability is computed.

Illustrative adjustment

	₦	₦
Net profit per accounts		280,000
Add:		
Expenditure charged in the account which is not deductible	100,000	-
Income taxable which has not been Included	60,000	160,000
		440,000
Less:		
Profits included in the accounts but which are not taxable	80,000	
Expenditure which is deductible but which has not been charged in the accounts	40,000	120,000
Profit adjusted for tax purposes		320,000

5.6 Expenses incurred in deriving exempt income

Section 27 (1)(h) of CITA (as amended) and as stated in 18.4.4 (f) above, any expense incurred in deriving tax exempt income, losses of a capital nature and any expense allowable as a deduction under the Capital Gains Tax Act for the purposes of determining chargeable gains are not allowed in the computation of a company's assessable profits. Put differently, where a deductible expense is incurred for the purposes of generating both exempt and non-exempt income, only the portion that relates to the income assessable to tax shall be allowed at a deduction.

Illustration 5.3

Crystal Clear Limited generated a profit of ₦2,000,000 during the year ended December 31, 2020. It incurred deductible expenses of ₦250,000. Out of the business profit of ₦2,000,000, only ₦1,400,000 is assessable to tax.

Required:

Compute how much of the expenses will be allowed for deduction for income tax purposes.

Solution 5.3

The formula to be applied is

$$\frac{A}{A + B} \times C$$

Where:

A = Income assessable to tax
B = Tax exempt income
C = Total available expenses

Arising from the above, the portion of the deductible expenses to be allowed as a deduction is computed thus:

$$\frac{₦1,400,000}{₦1,400,000 + ₦600,000} \times ₦250,000 = ₦175,000$$

5.7 Restriction on the deductibility of interest

Section 24 of CITA (as amended) and the seventh schedule restrict the interest deductible by a Nigerian company or a fixed base of a foreign company in Nigeria which incurs any expenditure by a way of interest or of similar nature in respect of debt issued by a foreign connected person, the excess thereon shall be a disallowable deduction for the purpose of this Act.

The excess interest referred to above means an amount of total interest paid or payable in excess of thirty percent (30%) of earnings before interest, taxes, depreciation and amortisation (EBITDA) of the Nigerian company in that accounting period.

A Nigerian subsidiary of a foreign company which is engaged in the business of banking or insurance is excluded from this rule. This rule shall apply to a Nigerian banking or insurance companies that are parents to foreign companies, where the Nigerian company paid interest to that foreign subsidiary.

Where for any assessment year, the interest expenditure is not wholly deducted against income, so much of the interest expenditure that has not been deducted, shall be carried forward to the following assessment year or assessment years, and it shall be allowed as a deduction against profits, if any, of any business carried on by it and assessable for that assessment year to the extent permitted in the paragraph stated above. However, it should be noted that no interest expenditure shall be carried forward for more than five assessment years immediately succeeding the assessment year for which the excess interest expenditure was first computed.

A penalty of ten percent (10%) and interest at the Central Bank of Nigeria monetary policy rate plus a spread to be determined by the Minister or any adjustments made by the Service relating to excess interest charged in any year, is payable by any person who violates the provision of the seventh schedule to the Act.

The interest expenses must comply with the Income Tax (Transfer Pricing) Regulations 2018, before applying the interest deductibility rule, as this rule does not replace the transfer pricing rule.
For any interest expense to be allowable deduction, it must be directly incurred in respect of loan or debt obtained wholly, exclusively, necessarily and reasonably for the production of profits chargeable.

5.8 Definitions

(a) "Connected persons" means:

- (i) Any person controlled by or under common control, ownership or management;
- (ii) Any person who is not connected but receives an implicit or explicit guarantee or deposit for the provision of corresponding or matching debt; or
- (iii) Any related party as described under the Nigerian Income Tax (Transfer Pricing) Regulations 2018.

(b) "Debt" means any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under "profits and gains of business or profession".

Illustration 5.4

Jones Nigeria Limited was incorporated on November 2, 2011, and it commenced business on April 4, 2012. ABC (Canada) Limited is its subsidiary in Canada.

An extract of the financial statements of Jones Nigeria Limited for the year ended December 31, 2020, revealed the following:

	₦
Assessable profit	1,000,000
Interests and depreciation deducted before arriving at the assessable profit of N1,000,000, are as follows:	
Interest on loan paid to:	
- Other creditors	500,000
- ABC (Canada) Limited	750,000
Depreciation	300,000

It was stated that out of the loan paid to other creditors, N200,000 was in respect of a loan obtained in generating tax-exempt profits.

Required:

(a) Compute the interest deductible in the relevant assessment year.
(b) State how the excess interest not deductible in the relevant assessment year will be treated.

Solution 5.4

(a) Jones Nigeria Limited
Computation of interest deductible in 2021 assessment year

Computation of earnings before interest, taxes, depreciation and amortisation (EBITDA)

	₦	₦
Assessable profit		1,000,000
Add:		
Interests deducted	1,250,000	
Depreciation	300,000	1,550,000
EBITDA		2,550,000

Interest deductible before restriction	
Interest paid to other creditors	500,000
Interest paid to ABC (Canada) Limited	750,000
Total interest expenses	1,250,000
Interest for tax exempt profit	(200,000)
Interest qualifying for deduction	1,050,000

Restriction:

30% of EBITDA (30% of ₦2,550,000)	=	₦765,000

Amount of interest deductible in 2021 assessment is the lower of:

(i)	30% of EBITDA (₦2,550,000)	=	₦765,000; or
(ii)	Interest qualifying for deduction	=	₦1,050,000

This is ₦765,000.

(b) Treatment of excess interest not deductible in the relevant assessment year

The excess interest of ₦1,050,000 less ₦765,000, which is ₦285,000, will be carried forward and added to the interest expense for that year with a view to computing the restriction for that year.

It should be noted that the excess interest of ₦285,000 may only be carried for a period not exceeding five years, that is, 2026 assessment year, whilst applying for each of the years, the same rule based on which the excess interest expenditure was first computed.

5.9 Tax or penalty borne by a company on behalf of another person

Section 27(1)(1) of CITA (as amended) disallows any tax or penalty borne by a company on behalf of another person as an allowable deduction for tax.

XYZ Company Limited hired a hall from ABC Nigeria Limited for the sum of ₦1,000,000, net of withholding tax, and decided to remit the withholding tax of ₦100,000 to the FIRS. XYZ Company Limited may deduct ₦1,000,000 as rent but ₦100,000 remitted to FIRS on behalf of ABC Nigeria Limited is not deductible.

5.10 Interest on loan relating to gas utilisation (downstream operations)

Hitherto, section 39(1) (e) of CITA, allowed interest payable on any loan obtained with the prior approval of the Minister for a gas project as tax deductible.

The Finance Act, 2019, deleted paragraph (e) mentioned above. Such interest on loan will only be deducted if the interest:

(a) Is in line with the interest deductibility rules introduced by section 24(a) of the seventh schedule of CITA;

(b) Satisfies the principle of wholly, exclusively, necessarily and reasonably for the production of profits chargeable (WREN); and

(c) Relates to income or profit that is not exempt from tax.

5.11 Chapter review

This chapter explains the reasons for profit adjustments, allowable and non- allowable items of income and expenditures, specific provision for bad and doubtful debt, donations. The chapters also include the amendments made to the provisions of companies income tax with respect to allowable deductions and non-allowable deductions.

5.12 Worked examples

5.12.1 Questions

(1) Mohammed Limited has been in business for many years and makes up accounts to November 30, annually. The statement of financial position contained the following for the year ended November 30, 2016:

	₦	₦
Gross profit		1,230,936
Miscellaneous income		31,440
		1,262,376
Salaries and wages	251,240	
Electricity and other utilities	19,260	
Rent and rates	145,080	
Repairs and renewals	40,920	
Motor vehicle expenses	130,140	
Depreciation	171,300	

	₦	₦
Interest and bank charges	27,120	
Bad and doubtful debts	40,540	
Miscellaneous expenses	44,840	
Legal and professional charges	30,900	
Pensions contributions [employer]	38,240	
Audit fees	34,400	
Donations and subscriptions	37,200	
Directors emoluments	36,000	
		1,047,180
Net profit		215,196
		======

You are given the following additional information:

(a) Bad and doubtful debts figure consists of: ₦

		₦
(i)	General provision	12,000
(ii)	Specific provision	27,100
(iii)	Bad debts written off	6,500
(iv)	Bad debts recovered	(5,060)

(b) Defalcation and embezzlement
A director defrauded the company to the tune of ₦40,000.
The other embezzlements were committed by junior staff.

(c) Miscellaneous income includes: ₦
Profit on disposal of property, plant and equipment 8,690

(d) Legal and professional charges include:

(i)	Debt collection	6,000
(ii)	Renewal of short leases	2,400
(iii)	Defense for traffic offence	1,500

(iv)	Land acquisition	15,000
(v)	Retainership fee	6,000

(e) Miscellaneous expenses comprise:

(i)	Court fine	2,400
(ii)	Exchange loss on translation of intercompany balance	25,140
(i)	Exchange loss on remittance	6,500
(ii)	Office expenses	10,800

(f) Donations and subscriptions comprise:

(i)	Lagos Chambers of Commerce	3,000
(ii)	Motor Boat Club	1,200
(iii)	Polo Club	1,000
(iv)	Political parties	30,000
(v)	National Relief Fund	2,000

Required:
Compute adjusted profit for the relevant assessment year.

(2) Olowojeunjeje Plc has been in buying and selling business for several years making up its accounts to July 31, annually. It's statement of trading, profit or loss for the year ended July 31, 2012, are as follows:

	₦	₦
Sale of Log. plywood etc		2,320,586
Inventory - 31-07-2007	1,140,796	
Inventory - 31-07-2008	(721,058)	
	419,738	
Cost of sale of imported		
Products including labour dues	640,690	
Draft interest for goods imported	18,666	
Goods lost and damaged	21,136	
Felling fees and royalties	5,128	
Rafting 2,000		
Store-insecticide-consumed	21,126	
Diesel oil and lubricants	7,178	
Engineering inventory depreciation	30,000	
Engineering spares	1,900	
Salaries and wages	120,000	
Pension contributions	31,260	
Technical school expenses & staff training	102,600	
Industrial training levy adjustment	2,760	
Stationery, postage and telephone	8,000	
Licenses and insurance	11,200	

Bank and other finance charges	21,000	
Legal and professional fees	70,000	
Donations and subscriptions	8,400	
Rent and rates	50,600	
Repairs and maintenance	11,368	
Depreciation	33,476	
Concession rent written off	10,912	
Loss on sale of property, plant and equipment	20,000	
Sundry trade expenses	5,138	
Bad debts provision	32,920	
Provision for bad and Doubtful debts	32,000	
Hire of equipment	40,000	
Advertising	67,200	
		1,847,156
Profit for the year		474,190
		=======

Note:

(a) Included in donations and subscription are:

(i) Institute of Chartered Accountants secretariat's project ₦5,000

(ii) Sports Council ₦400

(iii) Various other charitable donations to Island Club, Supreme Executive circle and kaukaus Club of Nigeria (each) ₦3,000

(b) Advertising includes a specific provision against impending international trade fair in which the company was to participate ₦50,000

(c) In arriving at the figures for bad debts, individual assessment of the debts was made

(d) Technical school expenses item is made up of the various amounts spent on furniture and equipment for the school building just completed.

(e) Legal and professional fees include ₦=30,000 paid to the company's lawyers in the defense of an action brought by a group of villagers on the company's concession.

Required:
Compute the adjusted profit for the relevant assessment year.

(3) It is not all items of expenses charged in the statement of profit or loss of a taxpayer that qualify as deductions from the income of a relevant year of assessment.

Required:
Justify this assertion with close reference to the provisions of Companies Income Tax Act. (CITA) - as amended in relation to allowable expenses.

5.12.2 Suggested solutions to open-ended Questions

(1) Mohammed Limited

Computation of adjusted profit For 2017 assessment year

	₦	₦
Net profit per accounts		215,196
Add:		
Depreciation	171,300	
General provision for doubtful debts	12,000	
Legal expenses: re-land acquisition	15,000	
Traffic offence	1,500	
Miscellaneous expenses: re-court fine	2,400	
Donations and subscriptions:		
- Motor boat club	1,200	
- Polo club	1,000	
- Political parties	30,000	
Translation of inter-company balances	25,140	
		259,540
		474,736
Deduct:		
Profit on sale of property, plant and equipment		8,690
Adjusted profit		466,046

(2) Olowojeunjeje plc

Computation of adjusted profit For 2013 Assessment year

Note	₦	₦
Net profit per accounts		474,190
Add:		
Depreciation	33,476	
Loss on sale of property, plant and equipment	20,000	
Doubtful debts provision	32,000	
Donations and subscriptions;		
- Charitable donations	3,000	
Provision:		
- Re : Impending trade fair	50,000	
Expenditure on furniture and equipment	102,600	241,076
Adjusted profit		715,266
		======

Note:

Charitable Donations

Schedule 5 Section 21 of CITA 1979 as amended specifically listed bodies to which companies can donate fund. Outside this list, donations shall be disallowed. Consequently, charitable donations of ₦3,000 being general has been disallowed.

3. Unless otherwise provided, for the purposes of ascertaining the chargeable profit or loss of any company from any source, only expenses incurred **wholly, exclusively, necessarily and reasonably** in the production of the profits shall be allowable as deductions for tax purposes.

Examples of allowable expenses provided for in CITA are:

(a) Subject to the provisions of the seventh schedule to this Act, any sum payable by way of interest on debt borrowed and employed as capital in acquiring the profits of a company;

(b) Rent and premium paid by the company for the period of assessment in respect of land or building, occupied and used for the purpose of generating the profits:

Where a building is occupied by the company's employees as residential accommodation, the rent or premium paid by the company which is chargeable or allowable in company's account for income tax purposes, is restricted to 100% of the basic salary of such employees;

(c) Salaries, wages, or other remuneration as well as any benefits-in-kind or allowance granted by the company to senior staff and executives within the limits prescribed by collective agreement entered into between the company and its employees and as approved by Federal Ministry of Labour, Employment and Productivity;

(d) Repairs and renewal in respect of premises, plant, machinery or fixtures, implements, utensils or articles employed in acquiring the profit;

(e) Bad debts incurred in the course of trade or business proved to have become bad, during the period and specific provision for doubtful debts;

(f) Research and development expenses incurred by the company for the period including levy payable to National Science and Technology Fund;

(g) In the case of the Nigerian Railway Corporation such deductions as are allowed under the provisions of the Authorised Deductions (Nigerian Railway Corporation) Rules, which Rules shall continue in force for all purposes of this Act;

(h) In the case of profits from a trade or business, any expenses or part thereof:

- The liability for which was incurred during that period wholly, exclusively, necessarily and reasonably for the purposes of such trade or business and which is not specifically referable to any other period or periods; or

- The liability for which was incurred during any previous period wholly, exclusively, necessarily and reasonably for the purpose of such trade or business and which is specifically referable to the period of which the profits are being ascertained; and

- The expenses proved to the satisfaction of the Service to have been incurred by the company on research and development for the period including the amount of levy paid by it to the National Science and Technology Fund;

(i) Such other deductions as may be prescribed by the Minister by any rule;

(j) Dividends or mandatory distributions made by a real estate investment company duly approved by the Securities and Exchange Commission, to its shareholders;

(k) Compensating payments, which qualify as interest under section 9(1)(c) of this Act, made by a lender to its approved agent or a borrower in a regulated securities lending transaction;

(l) Allowable donations **(Section 25, CITA)**

In ascertaining the profits or losses of a company chargeable to tax for any period, there shall be deducted, donations made during that period by the company.

The conditions for allowing such donations are as follows:

(i) Donations must be made to any of the funds, bodies, institutions in Nigeria contained in the Fifth schedule to CITA;

(ii) Donations must be made out of profit, that is, donations shall not be allowed in circumstances where it will increase the loss of a company or convert its profit into a loss;

(iii) Donations must not be of a capital nature except donation to a university or other tertiary or research institutions; and

(iv) Donations must not exceed 10% of the company's total profits for an assessment year before any deduction for donation. In the case of donation to tertiary or research institution, up to 15% of total profit or 25% of tax payable in the year whichever is higher.

(v) Donations made by companies in cash or kind to any fund set up by the Federal Government or any state government, or to any agency designated by the Federal Government or to any similar Fund or purpose in consultation with any Ministry, department or agency of the Federal Government, in respect of any pandemic, natural disaster or other exigency shall be allowed as deductions as follows:

(i) The cost of in-kind donations made to the Government and any designated agency shall be allowed as deductions; or

(ii) Where companies have either procured or manufactured items for contribution, the cost of purchase, manufacture or supply of such in-kind contributions shall be allowed as deductions.

Provided that requisite documentation evidencing the donation and the cost thereof are provided to the relevant tax authority and demonstrated to be wholly, reasonably, exclusively and necessarily incurred in relation to the procurement, manufacture or supply of the in-kind contributions.

(vi) The amounts allowable for deduction in respect of (v) above, in any year of assessment shall be limited to 10% of assessable profits after deduction of other allowable donations made by the company.

(m) **Allowable deductions - research and development expenditure**

In ascertaining the profit or loss of any company for any period from any source chargeable to tax, there shall be deducted the amount of reserve (provision) made out of the profits of that period for research and development.

Such provision shall not exceed ten percent (10%) of total profits of the company for that year before deducting the reserve/provision.

Companies and other organisations engaged in research and development activities for commercialisation shall be allowed 20% investment tax credit on their qualifying expenditure for that purpose.

Professional level

Advanced Taxation

6

Loss Relief

Contents

6.0 Purpose

After studying this chapter, readers should be able to:

(a) Know the characteristics of relevant loss relief procedure;
(b) Know the treatment of losses during commencement of business;
(c) Know how to treat losses when there is overlapping of basis periods; and
(d) Know the treatment of losses at cessation of business.

6.1 Introduction

A company makes a loss from its trade or business when it's allowable operating expenses exceed its total revenue.

In arriving at the chargeable profits of a company, losses, if any, brought forward from the preceding year of assessment are to be deducted. The carry forward loss relief is available to a corporate taxpayer.

6.2 Rules governing loss relief

Section 27 of the Act contains the provisions applicable to losses incurred by companies. Essentially, these are:

(a) The amount of the loss to be allowed should be that which the Revenue Service is satisfied as having been incurred by the company in a trade or business during a preceding year of assessment (Section 27(2)(a). The reference to preceding year in the wordings of that Section of CITA means logically current year losses cannot be relieved since the company must make profits in order to do so;

(b) In no circumstance shall the amount to be relieved exceed the total amount of the loss incurred;
(c) Relief can only be against profits from the same trade or business in which the loss was incurred;
(d) With effect from 2007, losses can be carried forward indefinitely and relieved against future profits; and

(e) The loss available for relief should be computed on the same basis as that of assessable profit, for a year of assessment.

6.3 Current year loss relief

This is one of the methods of relieving losses. It is applicable to only individuals. In this case, losses incurred from a particular source of income can be relieved against other sources. In order to enjoy this relief, a written claim must be made within 12 months after the end of the year of assessment in which the loss arises. It is important to note that the current year loss relief is applicable to a loss incurred only in the first year. Any unrelieved loss can only be set off against profit from the source from which the loss was incurred.

6.4 Carry forward loss relief

This is available to all taxpayers (individuals and companies). The features of this type of relief are as stated below:

(a) There is no need for a written application by the taxpayer as it is automatically granted to them;

(b) The relief is granted on preceding year basis;

(c) The loss of a source of income is relievable against future income earned from the same source of income; and

(c) The loss of a source of income shall be available for relief against future profit from the same source of income until it is fully relieved.

6.5 Terminal loss relief

There is no provision in the Act for the granting of relief for losses by a company in the year of assessment when its trade or business permanently ceases. Thus, there is no relief for any loss incurred in the last year of trade nor for any unrelieved loss accumulated up to the date of cessation.

The computation of the assessable income for the year of cessation will be on preceding year basis. Since a loss has been incurred for this period, assessment will be nil, for the assessment year concerned. However, there are provisions for the relief of unutilized capital allowances at the time of permanent cessation of a company's trade. Such capital allowances can be carried back to be relieved against the assessable profits of the preceding years up to the fifth year before the year of cessation (Sch. 2 para. 24(5)).

Illustration 6.1

Mr. Oluwalogbon established Goldmine Fisheries Limited in 2001 for the purpose of commercial fish production. The company commenced business on January 1, 2002.Its accounting date is 31 December each year while its adjusted profits for the first ten years are as follows:

Trading periods	Adjusted profits/(losses) ₦
Year ended 31/12/09	(100,000)
Year ended 31/12/10	30,000
Year ended 31/12/11	25,000
Year ended 31/12/12	20,000
Year ended 31/12/13	15,000
Year ended 31/12/14	35,000
Year ended 31/12/15	50,000
Year ended 31/12/16	(40,000)
Year ended 31/12/17	35,000
Year ended 31/12/18	30,000

Required:
Compute the assessable profits for the relevant years.

Suggested solution to illustration 6.1

Goldmine Fisheries Limited Computation of assessable profits

For 2009 – 20119 tax year

Tax year	Basis period	Assessable profits ₦	₦
2009	01/01/09 – 31/12/09		
	Loss for yearended31/12/09	(100,000)	NIL
	Loss c/fto2010	(100,000)	
2010	1st 12 months - 01/01/09–31/12/09	(100,000)	
	Loss b/ffrom2009	(100,000)	
	Loss c/f to 20011 restricted to actual loss sustained	(100,000)	NIL
2011	Preceding year basis - 01/01/10 – 31/12/10		
	Profit for yearended31/12/09	30,000	
	Loss b/ffrom20011	(100,000)	
	Loss c/fto2012	(70,000)	NIL
2012	Preceding year basis-01/01/11–31/12/11		
	Profit for yearended31/12/11	25,000	
	Loss b/ffrom2012	(70,000)	
	Loss c/fto2013	(45,000)	NIL
2013	Preceding year basis		
	Profit for yearended31/12/12	20,000	
	Loss b/ffrom2012	(45,000)	
	Loss c/fto2014	(25,000)	NIL

2014	Preceding year basis		
	Profit for year ended 31/12/13	15,000	
	Loss b/f from 2013	(25,000)	
	Loss c/f to 2015	(10,000)	NIL
2015	Preceding year basis		
	Profit for year ended 31/12/14	35,000	
	Loss b/f from 2014	(10,000)	25,000
2016	Preceding year basis		
	Profit for year ended 31/12/15	50,000	50,000
2017	Preceding year basis		
	Loss for year ended 31/12/16	(40,000)	
	Loss c/f to 2018	(40,000)	NIL
2018	Preceding year basis		
	Profit for year ended 31/12/17	35,000	
	Loss b/f from 2017	(40,000)	
	Loss c/f to 2019	(5,000)	NIL
2019	Preceding year basis		
	Profit for year ended 31/12/2018	30,000	
	Loss b/f from 2018	(5,000)	25,000

Notes:

i. Goldmine Fisheries Limited is allowed to carry forward unrelieved losses indefinitely and recoup same against future profits.

ii. Readers were not required to compute the tax liability as it is the computation of assessable profits that was required in the question.

6.6 Chapter review

This chapter defines what constitutes a loss for a company in trade or business and also provides rules on loss relief.

The readers must have known the operations of this relief in terms of how and when and to what category of taxpayers that can benefit from this relief. In addition, readers must have known the features and characteristics of carry forward loss relief applicable to the corporate taxpayers.

6.7 Worked examples

6.7.1 Questions

(1) According to the provisions of the Companies Income Tax Act (CITA), certain provisions apply to the corporate taxpayers in relation to loss relief procedures.

Required:
Examine these provisions with close reference to the Companies Income tax Act.

(2) Examine the features of the “carry forward” loss relief procedures on commencement of trade or business.

(3) (a) Explain what you understand by total profits in the context of company taxation

(b) Rodan Nigeria Limited has been in business for several years. The company makes up its accounts up to 30th June every year. The audited accounts for the years ended 30/6/08 to 30/6/12 contain the following information:

Year ended	Profit/(Loss)	Capital allowance	Interest on savings	Balancing charge
	₦	₦	₦	₦
30/6/08	(60,000)	20,000	4,000	2,000
30/6/09	200,000	24,000	6,000	5,000
30/6/10	240,000	28,000	8,000	-
30/6/11	(180,000)	40,000	7000	-
30/6/12	300,000	32,000	10,000	3,000

You are required to compute the total profits and tax payable by the company for the relevant year of assessment.

Suggested solution to questions

(1) The provisions of the Companies Income tax Act (CITA) contains the provisions applicable to losses incurred by companies. Essentially, these are:

(a) The amount of the loss to be allowed should be that which the Revenue Service is satisfied as having been incurred by the company in a trade or business during a preceding year of assessment. The reference to preceding year in the wordings of CITA means logically current year losses cannot be relieved since the company must make profits in order to do so;

(b) In no circumstance shall the amount to be relieved exceed the total amount of the loss incurred;

(c) Relief can only be against profits from the same trade or business in which the loss was incurred;

(d) With effect from 2007, losses can be carried forward indefinitely and relieved against future profits for all companies liable to tax under CITA with exception of insurance companies. However, the 2019 Finance Act has aligned the carrying forward of losses for insurance companies with other companies liable to tax under CITA. Therefore, the insurance companies can now carried forward losses indefinitely and relieved it against future profits;

(e) The loss available for relief should be computed on the same basis as that of assessable profit for a year of assessment.

(2) The features of carry forward loss relief on commencement of business are as follows:

(a) There is no need for a written application by the taxpayer as it is automatically granted to them;
(b) The relief is granted on preceding year basis;
(c) The loss of a source of income is relievable against future income earned from the same source of income; and
(d) The loss of a source of income shall be available for relief against future profit from the same source of income until it is fully relieved.

(3) a) The total profits of any company shall be its total assessable profits from all sources for the year together with any additions of balancing charges and deduction of unutilized losses brought forward, balancing allowances and capital allowances.

However, where a company has different sources of income from different businesses, the loss of one source of business cannot be offset against the profits of the other business and shall be carried forward to be offset against future profits of that source in accordance with provision of CITA. Indeed, a separate income statement should be prepared for each source before aggregation of the total profits.

(b)

RODAN NIGERIA LIMITED
COMPUTATION OF TAX PAYABLE
2009 Year of Assessment

Loss carried forward	(60,000)	
	======	
Capital allowance carried forward	20,000	
	======	
Interest on savings		4,000
Balancing charge		2,000

Total profit		6,000
		======

Tax liability at 30%			1,800
		======	
2010 Year of Assessment			
Adjusted profit		200,000	
Less: loss brought forward			(60,000)

			140,000
Less: Capital allowance: Brought forward	20,000		
For the year	24,000		
			(44,000)

Interest on savings			6,000
Balancing charge			5,000

Total profit			107,000

Tax liability at 30%			32,100
2011 Year of Assessment			
Adjusted profit		240,000	
Less: Capital allowance:			(28,000)

			212,000
Interest on savings			8,000

Total profit			220,000

Tax liability at 30%			66,000
			========
2012 Year of Assessment			
Adjusted loss carried forward		(180,000)	
		=======	
Capital allowance carried forward		40,000	
		=======	
Interest on savings			7,000
Total profit			7,000
			=======
Tax liability at 30%			2,100
			=======

2013 Year of Assessment

Adjusted profit		300,000	
Less: loss brought forward			(180,000)

			120,000
Less: Capital allowance: Brought forward	40,000		
For the year	32,000		

			(72,000)

			48,000
Interest on savings			10,000
Balancing charge			3,000

Total profit			61,000
			=======
Tax liability at 30%			18,300
			=======

Professional level

Advanced Taxation

7

Capital allowances

Content

1 Capital allowances

7.0 Purpose

At the end of this chapter, readers should be able to:

(a) Define qualifying capital expenditure (QCE) and ascertain with Constitutes QCE;
(b) Explain the various restrictions on capital allowance claims;
(c) Know the conditions for granting capital allowances;
(d) Calculate capital allowances on commencement of business;
(e) Calculate capital allowances for existing businesses operating under the going concern assumption;
(f) Compute capital allowances when there is cessation of business;
(g) Know when carrying backward of capital allowances is applicable; and
(h) Calculate capital allowances for assets on hire purchase.

7.1 Introduction

The provision for capital allowances is as contained in the Second Schedule to the CITA. It is granted in lieu of depreciation. Depreciation is the depreciable part of an asset written off over the useful life of the asset. However, there are several methods of calculating depreciation and none of the methods can be enforced on all the taxpayers.

Consequently, the taxpayers are at liberty to choose any of the methods. This freedom of choice will lead to different values of depreciation expense on similar assets acquired by different taxpayers on the same date and this is a reason for not allowing depreciation as a deductible expense in the process of computing assessable profit.

Thus, capital allowance reduces all the taxpayers to a common base as the rates adopted are the same.

7.2 Definitions and types of capital allowance

7.2.1 Definition of capital allowances

Capital allowances are a form of relief granted to any company which incurred qualifying capital expenditure during a basis period in respect of property, plant and equipment in use at the end of the basis period for the purpose of a trade or business.

Capital allowances are granted in place of depreciation which is usually disallowed for income tax purposes. Capital allowances include initial allowance, annual allowance, balancing allowance/(charge) and investment allowance.

7.2.2 Initial allowance

which would have been allowable except for this provision. This is granted in the first year of acquisition on the cost of purchase of the asset whether purchased new or second hand (but see the exception in respect of building). Initial allowance is granted in full irrespective of the number of months in the basis period of a relevant tax year. For example, an initial allowance of ₦25,000 will be claimed for a qualifying expenditure amounting to ₦50,000 on an asset which attracts an initial allowance rate of 50%. The initial allowance to be granted would be such an amount as the Revenue Service may determine to be just and reasonable where either the seller has control over the purchaser or the purchaser has control over the seller of the asset. Such amount shall not exceed the amount of the initial allowance.

In respect of qualifying expenditure on plant and machinery for the replacement of old ones, one-off 95% capital allowance in the first year shall be allowed. The 5% book value shall be retained until the final disposal of the asset provided that the aggregate capital allowances granted in respect of any asset shall not exceed 95% of the total cost of the asset (New Section 6(3) inserted in Decree 1996 No. 32, effective January 1, 1996).

7.2.3 Annual allowance

This is granted annually and is computed on the balance of cost after the deduction of the amount of initial allowance claim on the asset. In the example of the item shown under initial allowance above, the annual allowance, assuming a rate of 25% shall be ₦6,250, that is, 25% of (₦50,000 – ₦25,000). Annual allowance once calculated for particular property, plant and equipment item will be the same amount for each of the years that the asset is in use until the cost of the asset is fully relieved. A nominal sum of 10 per item is retained in the books in the last year of claim of annual allowance. It is retained until the item is disposed of.

Where the basis period for any year of assessment is a period of less than one year, the annual allowance for that year of assessment shall be proportionately reduced.

7.2.4 Investment allowance

In addition to an initial allowance, investment allowance can be claimed in respect of qualifying expenditure incurred on plant and machinery. The rate is 10% of the cost of qualifying expenditure.

The provisions of CITA relating to initial allowance also apply to investment allowance, except that an investment allowance is not to be deducted from cost of the assets in arriving at the residue of qualifying expenditure.

Investment allowance cannot be claimed, or if already granted, shall be withdrawn if any of the following happened within a period of five years from the date of acquisition of the assets:

(a) Any sale or transfer of the asset otherwise than to a person acquiring the asset for a chargeable purpose or for scrap;

(b) Any appropriation of the asset for a purpose other than a chargeable purpose;

(c) Any sale or transfer or other dealing with the asset being a case where it appears either:

   (i) That the purpose of obtaining tax allowances was the sole or main purpose of the company for incurring the expenditure or for so dealing with the asset; or

   (ii) That the incurring of the expenditure and the asset being so dealt with were not bona fide business transactions, or were artificial or fictitious transactions, and were designed for the purpose of obtaining tax allowances. For the purpose of this section, "chargeable purpose" means the purpose of putting the assets to a use such that profits accrue or are intended to accrue therefrom and will be chargeable to tax.

7.2.5 Rural investment allowance

This incentive is available to any taxpayer that locates its business not less than 20kms away from such facilities provided by the government as follows:

(a) Where there is no facility at all, 100% of expenditure incurred;

(b) Where there is no electricity; 50% of the expenditure incurred;

(c) Where there is no water; 30% of the expenditure incurred; and

(d) Where there is no tarred road; 15% of the expenditure incurred.

7.2.6 Characteristics of investment allowance

These include:

(a) It is claimable only on specified capital expenditure. These are expenditures on plant, equipment and machinery;

(b) It is claimable in the first tax year in which the asset is put into use by the taxpayer;

(c) It is not taken into consideration when the tax written down value (TWDV) of the qualifying capital expenditure is computed, that is, it is not deductible along with initial and annual allowances from cost of the qualifying capital expenditure; and

(d) In any year of assessment, where rural Investment allowance claimable is not fully utilized, it cannot be carried forward as is the case with initial and annual allowance.

7.3 Balancing allowance and balancing charge

7.3.1 Balancing allowance

When the sales value of an asset is less than the tax written down value (TWDV), the related loss shall attract balancing allowance. It is claimable as additional allowance along with other capital allowance items as discussed above.

7.3.2 Balancing charge

Where the sales value of an asset exceeds the TWDV, balancing charge arises. Balancing charge is a taxable income. It is to be added to the adjusted profit of the taxpayer to arrive at the assessable profit. Proceeds can also be in the form of insurance claim.

This is a claw back of capital allowances previously enjoyed by the company and should not exceed the reliefs actually given.

7.4 Capital allowance rates and restrictions under CITA

The following are the capital allowances rates:

	Initial allowance %	Annual allowance %
Buildings (Industrial & non-Industrial)	15	10
Mining	95	Nil
Plant: Agric production	95	Nil
Others	50	25
Furniture and Fittings	25	20
Motor Vehicles: Public transportation	95	Nil
Motor Vehicles: Others	50	25
Plantation equipment	95	Nil
Housing estate	50	25
Ranching and plantation	30	50
Research and development	95	Nil

The following should also be noted:

(a) In respect of qualifying expenditure on plant and machinery for the replacement of old ones, a one-off 95% capital allowance in the first year shall be allowed. The 5% book value shall be retained until the final disposal of the asset provided that the aggregate capital allowances granted in respect of any asset shall not exceed 95% of the total cost of the asset;

(b) A company engaged in gas utilisation (downstream operations) shall be granted accelerated capital allowances after the tax-free period of three years, as follows:

(i) An annual allowance of 90 per cent with 10 per cent retention, for investment in plant and machinery,

(ii) An additional investment allowance of 15 per cent which shall not reduce the value of the asset;

(c) Where double taxation relief is applicable, paragraph 23 of Schedule 2, permits a company to elect that the initial or annual allowance due to it, be calculated at a lesser rate than that which is normally applicable as summarised under capital allowances rates shown above. When such election is made, the lesser rate desired by the company shall be the appropriate rate to be used to compute the amount of the capital allowances due to the company for that year of assessment; and

(d) Capital allowances to be deducted from assessable profits of companies in any year are restricted to 662/3% of such assessable profits except for companies engaged in agro-allied industry and manufacturing.

Capital allowances are also restricted when:

(i) There is a private use, restrict amount granted to official use; and
(ii) The basis period is less than 12 months, restrict amount calculated to the number of months in the basis period.

7.5 Qualifying capital expenditure

Qualifying capital expenditure means expenditure incurred on an assets used for a trade or business, which qualifies for capital allowances in a basis period. Categories of capital expenditure that qualify for the grant of capital allowances are as follows:

(b) Plant, machinery or fixtures;

(b) Buildings, structures or works of a permanent nature;

(c) Mines, oil wells or other sources of mineral deposits of a wasting nature;

(d) Plantations;

(e) Research and development;

(f) Agricultural plant;

(g) Public transportation motor vehicles i.e. fleet of buses of not less than three used for public transportation

(h) Public transportation (inter-city) new mass transit coach of 25 seats and above operated by a recognized corporate private establishment

(i) Development or acquisition of software or other such capital outlays on electronic applications.

Any expenditure which is an allowable deduction in computing the profits of the company’s trade or business in accordance with the provisions of CITA, shall not be treated as qualifying expenditure.

7.6 Buildings, structures or works of a permanent nature

The distinction between industrial and non-industrial buildings is the same as in PITA. The definition of industrial building as given in the Second Schedule, paragraph 5(b) of CITA is reproduced below:

“Industrial building or structure means any building or structure in regular use:

(a) As a mill, factory, mechanical workshop or other similar purpose, or as a structure used in connection with any such buildings;

(b) As a dock, port, wharf, pier, jetty or other similar building structure;

(c) For the operation of a railway for public use or of a water or electricity undertaking for the supply of water or electricity for public consumption; and

(d) For the running of a plantation or for the working of a mine or other source of mineral deposits of a wasting nature."

Any building not falling into any of these descriptions will automatically be a non-industrial building. It should also be noted that the cost of land is not considered to be qualifying expenditure. Capital allowances, therefore, cannot be claimed on the cost of land included in the cost of any building. Such cost should be deducted from the cost of the building in the computation of the applicable capital allowances.

Buildings purchased

When a building is purchased, the relevant interest to the company making the purchase is the original cost of construction of the building or the price paid for it, whichever is lower. If the building is purchased second-hand, no initial allowance can be claimed by the purchaser but annual allowance can be claimed based on the amount of the relevant interest as defined above. When a building is purchased new, initial and annual allowances are claimable by reference to the relevant interest, that is, the cost of construction by the original owner or the purchase price, whichever is lower.

7.7 Mines, oil wells or other sources of mineral deposits of a wasting nature

This is covered among others in paragraphs 1 and 2, Second Schedule, CITA which contains similar provisions to PITA, Fifth Schedule, paragraph 2, but see comments under plantations below.

7.8 Plantations

Qualifying expenditure in connection with plantations is capital expenditure:

(a) On the clearing of land for planting; and

(b) On planting (other than replanting).

The part (c) of paragraph 1, Schedule 2, CITA deals with qualifying mining expenditure and is as follows:

(iii) Capital expenditure (hereinafter called "qualifying mining expenditure") incurred in connection with, or in preparation for, the working of a mine, oil well or other source of mineral deposits of a wasting nature (other than expenditure which is included in subparagraph (a) of this definition);"

(ii) Capital expenditure (hereinafter called qualifying plantation expenditure") incurred in connection with a plantation:

- On the clearing of land for planting
- On planting (other than replanting);
- On the construction of any works or buildings which are likely to be of little or no value when the source is no longer worked or, where the source is worked under a concession, which are likely to become valueless when the concession comes to an end to the company working the source immediately before the concession comes to an end;

- On the acquisition of, or of rights in or over, the deposits or on the purchase of information relating to the existence and extent of the deposits; and
- On searching for or on discovering and testing deposits, or winning access thereto".

A critical look at the third, fourth and fifth bullets will reveal that they have no bearing to plantations. In fact, they relate to mining expenditure. This is the treatment in PITA which in the absence of any evidence to the contrary, is also expected to be the same in CITA. Clearly, this is an error in the drafting of the Law.

7.9 Conditions for granting capital allowances

Capital allowances are granted if the following conditions are satisfied:

(a) The company claiming the allowance must be the owner of the assets at the end of its basis period for a year of assessment;

(b) The assets must be used for the purpose of a trade or business carried on by the company; [Note that the ownership and usage should be on the last day of the basis period of a year of assessment. For this purpose, a period of temporary disuse is ignored].

Also when an asset has been acquired but has not been put into use at the end of the basis period, capital allowances can be claimed provided the first use to which the asset will be put after that date is the purpose of the trade or business of the company. If eventually the asset is not put to such use, the Revenue Service can raise such additional assessment as might be necessary to counteract the benefit obtained from granting the capital allowances].

(c) The grant is for a year of assessment and is usually against the assessable profits of the basis period for that year of assessment. In the event of insufficiency of assessable profits to cover the claim due after the applicable restrictions, the unrelieved amount can be carried forward to future assessment years with no time limit.

(d) A claim should be made by the company before any capital allowance can be granted. However, if no claim is made, some allowances can still be granted where the Revenue is of the opinion that it would be reasonable and just to do so, for example, where Best of Judgment (BOJ) assessments are raised;

(e) Where the basis period for any year of assessment is a period less than one year, for example, when the commencement provisions are being applied, the annual allowance for that assessment year shall be proportionately reduced;

(f) The relief is granted by deduction from the remainder of assessable profits in the computation of the company's total profits. The remainder of the assessable profits is the assessable profits plus any balancing charge and less any loss relief due, that is capital allowance relief is granted after giving effect to loss relief;

(g) Unutilised allowances in the year of permanent cessation of a trade or business carried on by a company shall be available for relief against the remainder of its assessable profits for the preceding year of assessment and so on for other preceding years up to the fifth year before the year of permanent cessation;

(h) Where a relief is to be granted to a company after the assessment has become final and conclusive in respect of any assessment year, the Revenue Service may make such repayment or set-off of the tax, or any part of such tax, paid or charged for that year as may be appropriate, in lieu of making the deduction for the amount of the relief;

(i) The residue of expenditure is the total qualifying expenditure incurred less the total of any initial and annual allowances granted to date. Investment allowance should not be deducted from qualifying expenditure to arrive at the residue;

(j) In the year of permanent cessation of a trade or when an asset is disposed, balancing adjustment will need to be made. Balancing allowance will be granted when the proceeds of disposal or the value on the date of cessation is less than the residue of qualifying expenditure. A balancing charge, which will be limited to the capital allowances previously given, will be made if the value/proceeds is greater than the residue;

(k) There is no difference in the meaning of "disposed of" and "value of an asset" as contained in CITA Second Schedule paragraphs 12 and 13 respectively, and that contained in PITA Fifth Schedule dealing with personal taxation;

(l) The amount of capital allowances calculated is generally restricted to a percentage (at present 66 2/3%) of the assessable profits. Any company in the agro-allied industry or that which is engaged in manufacturing is not affected by this restriction.

A company in the agro-allied industry is any company carrying on agricultural trade or business, as defined.

Agricultural trade or business is defined in the Act as any trade or business connected with:

(iii) The establishment or management of plantations for the production of rubber, oil palm, coffee, tea and similar crops;

(iv) The cultivation or production of cereal crops, tubers, fruits of all kinds, cotton, beans, groundnuts, shea nuts, beniseed, vegetables, pineapples, bananas and plantains;

(v) Animal husbandry, that is to say, poultry, piggery, cattle rearing, fish farming, and deep sea fish-trawling"; and

(b) Any expenditure allowable under Section 20 as a trade expense and deductible the computation of the company's profit from its tradeor business cannot be treated as qualifying capital expenditure.

7.10 Calculation of capital allowances on assets acquired on hire purchase

A company or an individual taxpayer wanting to preserve liquid fund or that fall short of it may elect to enter into hire purchase agreement. Such agreement usually flexes the payment which is done in instalments. Since payment is made in piece meal, such arrangement will attract some interests on cost. Thus, usually the cost of acquiring on hire purchase will be higher than the cost of outright purchase by the margin of the interest charge as per agreement.

Hints on calculation

(a) The interest element must be identified and removed from hire purchase price to arrive at actual cost upon which calculation is based.

(b) Identify date of agreement and pay special attention to dates of payment of deposit and instalments.

(c) Calculate amount paid as deposit and instalments on due dates. Where there is Default in payment of an instalment, identify the actual date of payment.

(d) Determine the relevant year of assessment and related basis period for each payment.

(e) Identify and add all payments (deposit and instalments) falling within the basis period of each relevant year of assessment.

(f) Introduce each additional payment in (e) above as if treating a unit of asset newly acquired and calculate initial and annual allowance on each unit introduced.

(g) In calculating annual allowance (A.A) on new additional payment, the number of years already spent by the asset must be deducted from statutory years determined for the asset for capital allowance purposes.

7.11 Capital allowances on commencement of business – Finance Act, 2019

The provision of the Finance Act, 2019 eliminated the problems associated with overlapping of basis period on commencement of business because abnormal basis period is no more in operation as the preceding year basis rule applies in accordance with the Finance Act, 2019 . However, if the basis period in the year of commencement is less than twelve (12) months, the annual allowance will be prorated in the year of commencement.

7.12 Capital allowances for existing business operating under the going concern assumption

For this class of business, the tax written down values [TWDV] of existing assets shall be provided with relevant information relating to details of capital allowances granted on them from the first year of using them to the end of the current accounting year. Also details of additional assets acquired; costs of acquisition and dates of acquisition are very necessary for the computation of capital allowance.

Information relating to disposal of the nominal and tax written down values (TWDV), if any is also relevant. This will allow for the computation of balancing charge and or balancing allowance as may be appropriate.

Procedure for computation is as follows:

(a) Determine the first relevant tax year and allocate the TWDV of assets brought forward to it;

(b) Allocate the newly acquired assets to relevant tax years using the dates of Acquisition;

(c) Allocate disposals to relevant tax years using the dates of disposal; and

(d) Compute capital allowances as appropriate. Note that disposal must be done before the computation of capital allowance because any asset disposed within the year will not enjoy capital allowance.

7.13 Computation of capital allowance when there is cessation of business – Finance Act, 2019

The implementation of the provisions of the Finance Act, 2019 removed the issue relating to Actual year basis in the penultimate tax year and also eliminated the possibility of 'gap' between basis periods when there is cessation of business that used to be the case under the old provisions on cessation rules. This is because all tax years are based on preceding year basis as provided by the Finance Act, 2019. Meanwhile, where the basis period in the year of cessation of business is less than twelve (12) months, the annual allowance will be prorated.

7.14 Computation of capital allowances for small companies

Despite the fact that capital allowances are claimable on capital expenditure used to generate taxable income, these allowances are not allowable or carried forward in the case of small companies. Such a company can only claim the capital allowances on capital expenditure when it crosses the threshold of ₦25m as it will now qualify as either a medium or large company.

7.15 Carry back of capital allowances

On cessation of trade or business, unclaimed capital allowance in the assessment year in which trade permanently ceases may be carried back for relief against the total profits of the five years of assessment preceding the final year of trading.

7.16 Chapter review

This chapter identifies the salient difference between depreciation and capital allowance and the reason why depreciation is not an allowable expense. Readers should be in a position to know the different types of capital allowance - initial, annual, investment and rural investment allowance.

They should be able to compute capital allowances, balancing charge and balancing allowance and apply their computations to taxpayer's affairs, observing relevant restrictions as may be appropriate. In addition, the treatment of assets acquired on hire purchase and outstanding capital allowances as at the date of cessation of business is expected to be well comprehended.

7.16 Worked examples

7.16.1 Open-ended Questions

(1) On September 1, 2014 Idiaraba Limited entered into a hire purchase agreement with Idiarere Limited. Ten (10) Generators was acquired on hire purchase by Idiaraba Limited with N2,000,000 paid as initial deposit on that date. This was followed by twenty four equal monthly instalments of N200,000 commencing from November 30, 2014. The cash price of the ten (10) Generators was N5,600,000. Idiaraba Limited usually prepare its account to June 30 every year.

Required:
Compute the capital allowance for the relevant years of assessment. (Ignore investment allowance)

(2) Manufacturing Company Plc has been in business for several years. Financial statements are made up to June 30, every year. The following acquisitions of property, plant and equipment were effected in the year ended June 30, 2014.

	₦
Industrial buildings	5,000,000
Plant and machinery	1,750,000
Motor vehicles	3,500,000

The following disposals were made during the same year:
Motor vehicle acquired for N1,500,000 in year ended 30/6/2012 was sold for ₦2million.The residues of qualifying expenditure as at July 1, 2013 were:

	₦
Industrial building (5yrs more)	10,000,000
Plant and machinery (2yrs more)	2,000,000
Motor vehicles (2yrs more)	3,000,000

Required:
Compute the capital allowances for the relevant assessment years.

(3) There are several methods of calculating depreciation and none of the methods can be enforced on all taxpayers. Consequently, taxpayers are at liberty to choose any of the methods. This freedom of choice will lead to different values of depreciation expense on similar assets acquired by different taxpayers on the same date.

The above-stated assertion is one of the reasons that informed the decision of Revenue Service to disallow depreciation as a deductible expense in the process of computing assessable profit.

Consequently, capital allowance reduces all taxpayers to a common base as the rates adopted are the same.

Required:
Explain the conditions for granting capital allowances.

(4) Apex Limited incurred qualifying capital expenditure (QCE) of ₦2,000,000 on furniture and Fittings in 2020 assessment year when the revenue of the company was ₦24,000,000. The company achieved revenue of ₦27,000,000 in 2023 assessment year.

Required:
Compute the capital allowances claimable for all the relevant years of assessment.

7.16.2 Suggested solutions to open-ended Questions

(1) **Idiaraba Limited**

Computation of capital allowances for 2016 to 2019 years of assessment

Initial allowance rate (50%) and annual allowance rate (25%)

Tax year		I	II	III	capital allowance (₦)
2016	Cost	3,200,000			
	I.A	1,600,000			1,600,000
	A.A	400,000			400,000
					2,000,000
2017	TWDV	1,200,000			
	Cost		1,800,000		
	I.A		900,000		900,000
	A.A	400,000	300,000		700,000
					1,600,000
2018	TWDV	800,000	600,000		
	Cost			600,000	
	I.A			300,000	300,000
	A.A	400,000	300,000	150,000	850,000
					1,150,000

2019	TWDV	400,000	300,000	150,000	
	A.A	400,000	300,000	149,900	849,900
		0	0	100	

Working Notes:

1. Principal for capital allowance

	₦
Deposit	2,000,000
Instalment (24 × 200,000)	4,800,000
Hire purchase price	6,800,000
Cash price	5,600,000
Hire purchase interest	1,200,000
Number of instalments	24
Interest per instalments	50,000
Principal (200,000 – 50,000)	150,000

2. Schedule of payment

Tax year	basis period	no of instalment	amount
2016	1/7/14 – 30/6/15	8	1,200,000
Deposit			2, 00,000
			3,200,000
2017	1/7/15 – 30/6/16	12	1,800,000
2018	1/7/16 – 30/6/17	4	600,000

3. 2016 Annual allowance

Annual allowance $= \frac{3,200,000 - 1,600,000}{4}$ = ₦400,000

4. 2017 annual allowances

(i) Annual allowance $= \frac{1,200,000}{4 - 1}$ = ₦400,000

(ii) Annual allowance $= \frac{1,800,000 - 900,000}{4 \quad - 1}$ = ₦300,000

5. 2018 annual allowances = TWDV/unexpired tax life

(i) Annual allowance =800,000/2 = N400,000

(ii) Annual allowance = 600,000/2 = N300,000

(iii) Annual allowance = 300,000/2=N150,000

6. 2019 Annual allowances = TWDV/Unexpired tax life

(i) Annual allowance =400,000/1 = N400,000

(ii) Annual allowance = 300,000/1 = N300,000

(iii) Annual allowance = (150,000/2) less N100=N149,900

Note:
In 2019 tax year, it is apparent that this is the last tax year of the generator. Consequently, there is the need to retain the mandatory ₦10 per asset. Since there are ten generators, the sum of 100 must be retained, hence the claim of ₦149,900 instead of the expected ₦150,000 from the last instalment.

(2) **Manufacturing Company Plc**
2015 Capital allowances computation

	Industrial building	Non-Plant & machinery	Motor vehicles	Total allowances
	₦'000	₦'000	₦'000	₦'000
Residue b/f	10,000	2,000	3,000	
Disposal at WDV	-	-	375	
Net residue (A)	10,000	2,000	2,625	
Additions:	5,000	1,750	3,500	
Investment allow.		175		
Initial allow.	750	875	1,750	3,375

	Industrial building	Non-Plant & machinery	Motor vehicles	Total allowances
Balance after initial allow (B)	4,250	875	1,750	
	₦	₦	₦	₦
AA on 2015 additions	425	219	438	
AA on residue	2,000	1,000	1,313	
Total annual allowances (C)	2,425	1,219	1,751	5,395
Residue c/f (A + B – C)	**11,825**	**1,656**	**2,624**	

WDV of disposal 2013 Assessment year Motor vehicle cost

Year end 30/6/2012	1,500,000
Less: Initial allowance	750,000
Balance after initial allowance	750,000
Annual allowance	187,500
Tax written down value of disposal	375,000

Note that disposal was in 2015 Assessment year. Vehicle was not in use on the last day of the basis period for the assessment year. Thus annual allowance cannot be claimed for the vehicle in 2015 Assessment year.

Summary of capital allowances	**₦**
Investment allowance	175,000
Initial allowance	3,375,000
Annual allowance	5,395,000
Balancing charge	1,125,000
Balancing charge on vehicle disposed	
Sales proceeds	2,000,000
Less: Tax written down value at time of disposal	375,000
Surplus	**1,625,000**

Balancing charge has to be restricted to capital allowance previously

Cost	1,500,000
WDV	375,000
Therefore, capital allowance previously granted	1,125,000
Balancing charge	**1,125,000**

Granted:

(3) **Conditions for granting capital allowances**

Capital allowances are granted if the following conditions are satisfied:

(a) The company claiming the allowance must be the owner of the assets at the end of its basis period for a year of assessment;

(b) The assets must be used for the purpose of a trade or business carried on by the company; [Note that the ownership and usage should be on the last day of the basis period of a year of assessment. For this purpose, a period of temporary disuse is ignored].

Also, when an asset has been acquired but has not been put into use at the end of the basis period, capital allowances can be claimed provided the first use to which the asset will be put after that date is the purpose of the trade or business of the company. If eventually the asset is not put to such use, the Revenue Service can raise such additional assessment as might be necessary to counteract the benefit obtained from granting the capital allowances];

(c) The grant is for a year of assessment and is usually against the assessable profits of the basis period for that year of assessment. In the event of insufficiency of assessable profits to cover the claim due after the applicable restrictions, the unrelieved amount can be carried forward to future assessment years with no time limit;

(d) A claim should be made by the company before any capital allowance can be granted. However, if no claim is made, some allowances can still be granted where the Revenue is of the opinion that it would be reasonable and just to do so, for example, where Best of Judgment (BOJ) assessments are raised;

(e) Where the basis period for any year of assessment is a period less than one year, for example, when the commencement provisions are being applied, the annual allowance for that assessment year shall be proportionately reduced;

(f) The relief is granted by deducting from the remainder assessable profits in the computation of the company's total profits. The remainder of the assessable profits is the assessable profits plus any balancing charge and less any loss relief due, that is, capital allowance relief is granted after giving effect to loss relief;

(g) Unutilised allowances in the year of permanent cessation of a trade or business carried on by a company shall be available for relief against the remainder of its assessable profits for the preceding year of assessment and so on for other preceding years up to the fifth year before the year of permanent cessation;

(h) Where a relief is to be granted to a company after the assessment has become final and conclusive in respect of any assessment year, the Revenue Service may make such repayment or set-off of the tax, or any part of such tax, paid or charged for that year as may be appropriate, in lieu of making the deduction for the amount of the relief;

(i) The residue of expenditure is the total qualifying expenditure incurred less the total of any initial and annual allowances granted to date. Investment allowance should not be deducted from qualifying expenditure to arrive at the residue;

(j) In the year of permanent cessation of a trade or when an asset is disposed, balancing adjustment will need to be made. Balancing allowance will be granted when the proceeds of disposal or the value on the date of cessation is less than the residue of qualifying expenditure. Abalancing charge, which will be limited to the capital allowances previously given, will be made if the value/proceeds is greater than the residue;

(k) There is no difference in the meaning of "disposed of" and "value of an asset" as contained in CITA Second Schedule paragraphs 12 and 13 respectively, and that contained in PITA Fifth Schedule dealing with personal taxation;

(l) The amount of capital allowances calculated is generally restricted to a percentage (at present 66 2/3%) of the assessable profits. Any company in the agro-allied industry or that which is engaged in manufacturing is not affected by this restriction;

A company in the agro-allied industry is any company carrying on agricultural trade or business, as defined. Agricultural trade or business is defined in the Act as any trade or business connected with:

(i) The establishment or management of plantations for the production of rubber, oil palm, coffee, tea and similar crops;

(ii) The cultivation or production of cereal crops, tubers, fruits of all kinds cotton, beans, groundnuts, shea nuts, beniseed, vegetables, pineapples, bananas and plantains;

(iii) Animal husbandry, that is to say, poultry, piggery, cattle rearing, fish farming, and deep sea fish-trawling"; and

(m) Any expenditure allowable under Section 20 as a trade expense and deductible in the computation of the company's profit from its trade or business cannot be treated as qualifying capital expenditure.

(4) Apex Limited

Computation of capital allowances for 2020 to 2024 assessment years.

		Furniture and Fittings		
Initial allowance - 25%				
Annual allowance – 20%				
		Total capital allowances	**Cost**	**Remarks**
	₦	₦	₦	
Assessment year 2020				
Cost			2,000,000	
Initial allowance	500,000			
Annual allowance	300,000	800,000		
Assessment year 2021				
Annual allowance	300,000	1,100,000		
Assessment year 2022				
Annual allowance	300,000	1,400,000	(1,400,000)	**Not utilised**
W.D.V. c/f to A.Y. 2023			600,000	
Assessment year 2023				
Annual allowance			(300,000)	
W.D.V c/f to A.Y. 2024			300,000	
Assessment year 2024				
Annual allowance			(299,990)	
Amount retained in the books			10	

Note:

Given the fact that the company did not achieve the N25,000,000 revenue until 2023 assessment year, it will be regarded as a small company and the initial allowance of ₦500,000 (25%) and the annual allowance of ₦300,000 (₦1,500,000 x 20%) will be deemed utilised in assessment years 2020, 2021 and 2022.

The written down value of the QCE brought forward to A.Y. 2024 will be ₦2,000,000 less ₦500,000 (I.A), less ₦900,000 (A.As for 3years), which equals ₦600,000.

The capital allowances claimable in A.Y. 2023 is ₦300,000, whilst that of A.Y. 2024 is ₦299,990, that is ₦300,000 less retention of ₦10.

8

Concept of total profit

Contents

1 THE CONCEPT OF TOTAL PROFIT

8.0 Purpose

At the end of this chapter, readers should be able to:

(a) Compute adjusted/assessable profit;
(b) Know the relevance of adjusted profit in the determination of total profit;
(c) Know how to capture loss relief and capital allowance in the computation of companies income tax;
(d) Identify the objectives of Tertiary Education Trust Fund (Establishment) Act 2011;
(e) Compute minimum tax;
(f) Compute total profit;
(g) Identify basis of computing companies income tax;
(h) Know other bases of computing companies income tax; and
(i) Compute companies income tax.

8.1 Introduction

This concept explains the procedure for assessing limited liability companies to tax. It involves:

(a) Capturing all the company's chargeable income relating to a particular accounting year;
(b) Allowing for the deduction of all relevant and allowable expenses from such income as identified in (a) above;
(c) Granting of loss relief;
(d) Granting of capital allowance; and
(e) Computing total profit.

After capturing (a) to (d) above, the remaining profit is referred to as total profit. For each year of assessment, tax is payable at the current rate of 0%, 20% and 30% of total profit of small, medium size and large company respectively.

8.2 Definitions

8.2.1 Adjusted profit/assessable profit.

Adjusted profit is determined by taken the net profit made by the company during the basis period, plus disallowable expenses and taxable income not reported, less allowable expenses not reported and non-taxable income reported.

8.2.2 **Total profit**

Total profit is arrived at after the deduction of loss relief and the granting of capital allowance from adjusted profit.

8.3 Format showing assessable profit and total profit

To assist readers, the format of the computation of companies income tax payable is stated below:

Companies income tax
Ascertainment of total profit (Section 27)

	₦	₦
Profit as per accounts		XXX
Add back: All disallowed items, for example:		
Depreciation	XX	
Capital expenses on shares	XX	
Rent disallowed	XX	
Donations	XX	
General provision for bad debts	XX	
Diminution in value of investment	XX	XXX
		XXX
Less:		
Profit on sale of property, plant and equipment	XX	
Profit on export sales	XX	
Non-taxable incomes		
(Interest on agric or export loans)	XX	XXX
Assessable profit (AP)		XXX
Less: Loss relief (Sec. 27)		XXX
		XXX
Add: Balancing charge (Schedule 2)		XXX
Less: Investment allowance (Sec. 28)		XXX
		XXX
Less: Capital allowance (Schedule 2):		
Initial	XX	
Annual	XX	
Balancing allowance (Schedule. 2)	XX	
Restricted to 66 2/3% of Assessable profit (where necessary)	(XX)	(XX)
Capital allowance c/f	XX	
Total profit (TP)		**XXX**
Companies income tax payable, using applicable rates based on total profit, excluding small companies		XXXX
Tertiary education tax payable (2% of AP), except small companies		XXXX
Total tax payable		XXXX

8.4 Tertiary education tax

8.4.1 Objectives of Tertiary Education Fund (Establishment etc) Act, 2011

Education tax was introduced into the Nigerian tax system through the Education Tax Act, 1993 (ETA 1993),which metamorphosed into Education Tax Act CAP E4 LFN 2004 but is now repealed by the Tertiary Education Fund (Establishment etc) Act, 2011 to address the funding crisis in the education sector. The Act aims at involving the private sector, being a beneficiary of the products of education to partake in its funding through contribution to the Tertiary Education Trust Fund (TET Fund). This has, however, generated a lot of criticism in view of the presence of many taxes in the country which cumulatively erode the profits of companies, hence the general perception of education tax as a disincentive to foreign investment.

The fund will be specifically used for the provision or maintenance of the following:

(a) Essential physical infrastructure for teaching and learning;

(b) Instructional material and equipment;

(c) Research and publication;

(d) Academic staff training and development; and

(e) Any other need which, in the opinion of the Board of Trustees, is critical and essential for the improvement of quality and maintenance of standards in higher educational institutions.

8.4.2 Basis of computation

The rate of tertiary education tax is 2 percent of the assessable profit of a company registered in Nigeria. Note that assessable profit is adjusted profit or part thereof that is assessed to companies income tax in an assessment year. The tertiary education tax imposed is due and payable within 60 days after the Federal Inland Revenue Service has served notice of the assessment on a company.

Note that in line with the provisions of the Finance Act, 2020, and effective 2021 year of assessment, small companies are not liable to payment of tertiary education tax.

8.4.3 Assessment and collection

The Federal Inland Revenue Service assesses and collects from each company, tertiary education tax for an accounting period of the company.

The Act provides that:

(a) When assessing a company for companies income tax or petroleum profits tax for an accounting period of the company, the FIRS shall also proceed to assess the company for the tertiary education tax due; and

(b) The provision of the Act relating to the collection of companies income tax or petroleum profits tax shall subject to this Act, apply to the tertiary education tax due under the Act.

The Federal Inland Revenue Service shall pay the tertiary education tax collected into the TET Fund and shall when doing so, submit to the TET Fund, in such form as the Board of Trustees of the TET Fund shall approve, a return showing:

(a) The name of the company making the payment;

(b) The amount collected;

(c) The assessable profit of the company for the accounting period; and

(d) Such other information as may be required by the TET Fund for the proper administration of the tertiary education tax.

The Board of Trustees shall before the disbursement of the amount in the fund, set aside in each year, an amount not exceeding five percent of the total monies accruing to the fund in the preceding year which shall be applied for:

(a) The cost of administration and management of the fund;

(b) The maintenance of any property acquired by or vested in the fund and generally to pay for services rendered to the fund;

(c) For project monitoring; and

(d) To meet all the needs of the fund necessary for the due administration and implementation of the purpose of the Act.

8.4.4 Management and administration of the TET Fund

The Board of Trustees is vested with the management and administration of the Fund. The Board of Trustees shall administer the tax imposed by the Act and disburse the amount in the fund to federal and state tertiary educational institutions in the country.

8.4.5 Composition and functions of the Board of Trustees

(a) Composition

The Board of Trustees shall consist of:

(i) A Chairman;

(ii) Six persons, each representing a geo-political zone in the country;

(iii) A representative of the Federal Ministry of Education who shall not be below the rank of a director;

(iv) A representative of the Federal Ministry of Finance who shall not be below the rank of a director;

(v) A representative from the universities;

(vi) A representative from the polytechnics;

(vii) A representative from the colleges of education; and

(viii) the Executive Secretary of TET Fund who shall be the Secretary to the Board of Trustees.

This brings the total number of members of Board of the Trustees to thirteen persons. The membership of the Board of Trustees shall reflect the six-geopolitical zones of the federation and members shall be persons of considerable experience from both the public and private sectors and appointed by the President on the recommendation of the Education Minister to represent the business, financial and education sectors.

Each member other than the ex-officio members shall hold office for a term of four years in the first instance and may be eligible for re- appointment for a further term of four years and no more.

The board shall meet for the conduct of its ordinary meetings four times in a calendar year. Notwithstanding, the board may meet to conduct such other business as exigency demands.

(b) Functions

The following are the functions of the Board of Trustees:

(a) Monitor and ensure collection of tertiary education tax by the FIRS and ensure transfer to the fund;

(b) Manage and disburse the fund

(c) Liaise with the appropriate ministries or bodies responsible for collection or safekeeping of the tax;

(d) Receive requests and approve relevant projects after due consideration;

(e) Ensure disbursement of funds to various public tertiary educational institutions in Nigeria:

(f) Monitor and evaluate execution of the projects;

(g) Invest funds in appropriate and safe securities;

(h) Update the federal government on its activities and progress through annual and audited reports;

(i) Review progress and suggest improvements;

(j) Make and issue guidelines from time to time to all beneficiaries on disbursements from the fund and the use of monies received into the fund and;

(k) Regulate the administration, application and disbursement of monies from the fund; and

(l) Do such other things as are necessary or incidental to the objects of the TET Fund under the Act or as may be assigned by the Federal Government of Nigeria.

(c) Allocation of distribution of the tax

The total tax collected in a year is disbursed in the ratio 2:1:1 amongst the universities, polytechnics and colleges of education, as shown below:

(i)	Universities	-	50%
(ii)	Polytechnics	-	25%

(iii) Colleges of Education - 25%

The Board of Trustees shall have power to give due consideration to the peculiarities of each geo-political zone in the disbursement and management of the tax imposed by the Act between the various levels of tertiary education.

(d) Offences and penalties

If tertiary education tax is not paid within 60 days, the Federal Inland Revenue Service will serve, on the company, a demand note for the unpaid tax and a sum which is equal to 5 per cent of the tax. In addition to such penalty, the tax payable shall carry interest at bank lending rate from the date when the tax becomes payable until it is paid.

If the tax and penalty are not paid within a further period of two months of the demand, the company is guilty of an offence. The FIRS shall with the approval of the Board of Trustees of TET Fund remit in whole or in part a sum added to the unpaid tax.

Notice that other officers of such company are severally guilty of that offence of default and liable to be prosecuted against and punished for the offence in like manners as if they themselves committed the offence, unless they prove that the act or omission constituting the offence took place without his knowledge, consent or connivance.

The person guilty of the offence shall, on conviction, be liable:

(a) For the first offence, to a fine of up to N1,000,000 or imprisonment for a term of six months; and

(b) For a second and subsequent offence, to a fine of up to ₦2,000,000 or Imprisonment for a term of twelve months, or both such fine and imprisonment.

Note

Section 35 of the Finance Act, 2020, deleted section 10 of Tertiary Education Trust Fund (Establishment, etc) Act, 2011, which relates to offences. The implication of this is that there are no recognised offences in the administration and application of the Act.

In the same vein, section 36 of the Finance Act, 2020, deleted section 11(3) of Tertiary Education Trust Fund (Establishment, etc) Act 2011, which relates to penalties for those who are found guilty of any of the offences under the Act.

It is, however, surprising that section 11(2) of Tertiary Education Trust Fund (Establishment, etc) Act, 2011, is still retained. It states “The institution of proceedings or imposition of a penalty under the Act shall not relieve a company from liability to pay to the Federal Inland Revenue Service a tax which is or may become due under this Act”.

Arising from the above, it is believed that it is only when there are offences that the issue of penalties can arise. Pending further clarification(s) from the Service, the offences as stated in the first three paragraphs are retained.

Illustration 8.1

Zepon Limited extract of operating results as per audited financial statements for the year ended October 31, 2013, is as follows:

	₦'000
Operating profit	1,490
Provision for depreciation	610
Interest on borrowed fund	412
Provision for general debts	390
Balancing allowance	290
Balancing charge	220
Stamp duty on increase in capital	180
Capital allowances agreed	610

Required:

Compute assessable profit and tertiary education tax for the relevant year of assessment.

Suggested solution to illustration

8.1 Zepon Limited

Computation of adjusted profit and tertiary education tax For 2014 Assessment year

8.5

	₦'000	₦'000
Profit as per accounts		1,490
Add back disallowable expenses:		
Depreciation	610	
Provision for general bad debts	390	
Stamp duty on increase in capital	180	1,180
Assessable profit		2,670
Tertiary education tax liability		
(2% of assessable profit)		53.40

Tax implications of Classification of Nigerian Companies

The provisions of the Companies Income Tax Act (CITA) prior to commencement of

Finance Act, 2019, was that all Nigerian companies are liable to the same Companies Income Tax (CIT) rate of 30% with exception of small businesses (i.e. companies with less than ₦1,000,000 turnover) that are taxed at reduced rate of 20%.

The Finance Act, 2019, has classified companies into various categories with different tax rates as follows:

Types of companies	**Basis of classification**	Applicable tax rate
Small companies	Annual turnover of N25,000,000 and below	0%
Medium-sized companies	Annual turnover of above N25,000,000 but less than N100,000,000	20%
Large companies	Annual turnover of N100,000,000 and above	30%

Implications of classification of Nigerian companies
The implications include:

- Small businesses are still required to register for tax, prepare audited financial statements and file tax returns as and when due;
- Small companies are no longer liable to Withholding Tax (WHT) on their income since WHT is an advance payment of income tax; and
- The Finance Act, 2020, stipulates that the Federal Inland Revenue Service (FIRS) may prescribe the form of accounts other than audited financial statements for small and medium sized companies as defined under CITA.

8.6 Normal basis for computing companies income tax payable

In line with the provisions of the Finance Act, 2019, companies income tax is payable at the current rate of 0%, 20% and 30% of total profit of small, medium size and large company, respectively.

8.7 Other bases of computing companies income tax payable

Apart from the above, other bases of determining the income tax payable by a company are as follows:

(i) Minimum tax basis	-	Section 33 CITA
(ii) Revenue (turnover) basis	-	Section 30 CITA
(iii) Dividend basis	-	Section 19 CITA

8.7.1 Minimum tax basis - Section 33 CITA (as amended)

Section 105 of CITA, having been amended by Finance Act, 2020, **"gross turnover"** means the gross inflow of economic benefits during the period arising in the course of the operating activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants, including sales of goods, supply of services, receipt of interest, rents, royalties or dividends.

The following companies are specifically exempted by Finance Act, 2019, from the payment of minimum tax:

(a) A company with a gross revenue of less than ₦25,000,000 in the relevant year of assessment;

(b) Companies carrying on agricultural trade or business as defined in section 11(4) of CITA (as amended); and

(c) A company that has not been in business for more than four calendar years of its commencement of business.

Section 80(3) of CITA (as amended) defines "franked investment income" as dividend received by one company from another after the deduction of withholding tax.

The following should be noted:

(a) Any dividend received without the deduction of withholding tax will not be deducted from gross turnover in the computation of the minimum tax liability;

(b) Evidence of deduction of withholding tax deducted at source is a condition precedent before treating the dividend as franked investment income; and

(c) Where the franked investment income did not form part of the gross turnover, it should not be deducted from same in computing minimum tax.

The minimum tax to be levied and paid shall be 0.5% of gross turnover of the company, less franked investment income. Based on Finance Act, 2020, minimum tax is to be computed at 0.25% of gross turnover less franked investment income, for assessment years falling due between January 1, 2020 and December 31, 2021.

Illustration 8.2

APAD Nigeria Limited has been in business for many years. An extract of the profit or loss account of the company for the year ended December 31, 2021, revealed the following:

	₦	₦
Revenue/turnover from main business activities		25,000,000
Revenue from suspended operations	3,500,000	
Expenses on suspended operations	(2,400,000)	
Profit from suspended operations	1,100,000	1,100,000
Rent received (gross)		750,000
Dividend received from APD Limited (gross)		2,400,000
Revenue from other operating activities	7,500,000	
Expenses on other operating activities	(2,800,000)	
Profit from other operating activities	4,700,000	4,700,000

Required:

Compute the minimum tax payable.

Suggested solution 8.2

Based on the provisions of the Finance Act, 2020, the minimum tax payable is computed thus:

	N
Revenue/turnover from main business activities	25,000,000
Revenue from suspended operations	3,500,000
Rent received (gross)	750,000
Dividend received from APD Limited (gross)	2,400,000
Revenue from other operating activities	7,500,000

Total revenue/turnover	39,150,000
Divided received from APD Limited (franked investment income	(2,400,000)
Gross turnover for the computation of minimum tax	36,750,000

The minimum tax payable is 0.25% x ₦36,750,000 = ₦91,875

Illustration 8.2

8.7.2 Revenue (turnover) basis – Section 30 CITA (as amended)

Section 105 of CITA, having been amended by Finance Act, 2020, **"gross turnover"** means the gross inflow of economic benefits during the period arising in the course of the operating activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants, including sales of goods, supply of services, receipt of interest, rents, royalties or dividends.

The Federal Inland Revenue Service (FIRS) is given the discretionary power, by virtue of the provision of Section 30 of CITA, to assess and charge a company to tax on a fair and reasonable percentage of the turnover of the trade or business. The FIRS is entitled to exercise this power in any of the following circumstances where it appears to it that for any year of assessment, the company's trade or business has either:

(a) No assessable profits; or
(b) Assessable profits which in the opinion of the FIRS, are less than might be expected to arise from that trade or business; or
(c) The true amount of the assessable profit cannot be readily ascertained.

The implication of the above provision is that whatever is obtained by applying a fair and reasonable percentage, as may be determined by the FIRS, to the company's revenue, is deemed to be its assessable profit for the assessment year concerned.

Illustration 8.3

Ojokoro (Nigeria) Limited is engaged in general merchandising. The following details were extracted from the tax returns submitted to the Federal Inland Revenue Service for assessment year 2021.

	₦ '000
Revenue	100,000
Assessable profit	5,850
Balancing charge	500
	6,350
Less	
Unrelieved loss brought forward	1,200
	5,150
Capital allowance	(2,500)
Total profit	2,650
Companies income tax payable	

₦2,650,000 at 30%	₦795,000

An extract from the company's financial statements revealed the following additional information:

	₦'000
Gross profit	9,780
Net assets	48,500
]Share capital	30,000
Shareholders' funds	48,500

A desk examination by the Inland Revenue officials revealed the following:

(a) Revenue was understated by ₦5million; and

(b) Expenses were overstated by ₦1.5million. The tax official observed that the accounts submitted by the company were not reliable and that based on industry average, the gross profit percentage of about 10% revealed by the company's accounts was not reasonable.

Accordingly, the Revenue decided to revise the companies income tax computation by applying a fair and reasonable percentage of 25% on the revenue.

Required:
Re-compute the companies income tax liability for the 2021 Assessment year. (ignore mimimun tax computation).

Suggested solution to illustration

8.3 Ojokoro (Nigeria) limited

Computation of companies income tax liability Assessment year 2021

	₦'000
Revised assessable profit	26,250
(105m (100m+5m) x 25%)	
Add:	
Balancing charge	500
	26,750
Deduct:	
Unrelieved losses brought forward	(1,200)
	25,550
Capital allowances	(2,500)
Total profit	**23,050**
Companies income tax payable	
N23,050,000 at 30%	₦6,915,000

8.7.3 Dividend basis – Section 19 CITA

Prior to Finance Act, 2019, the provisions of Section 19 of CITA was where a dividend is paid out of profit on which no tax is payable due to:

(a) No assessable profits; or

(b) Assessable profits being less than the dividend paid, the company paying the dividend shall be charged to income tax at the at the appropriate rate on the dividend paid, where appropriate, as if it were its total profit for the assessment year to which the accounts from which the dividend was declared relate.

(c)

The Finance Act, 2019, excludes the following classes of dividend from the same treatment as those stated above:

(a) Dividends paid out of retained earnings of a company, provided that the dividends are paid out of profits that have been subjected to tax under Companies Income Act (CITA), Petroleum Profits Tax Act (PPTA) or the Capital Gains Tax Act (CGTA);
(b) Dividends paid out of all tax-exempt incomes pursuant to the CGTA, PPTA and Industrial Development (Income Tax Relief) Act or any other legislation;
(c) All franked investment income under CITA; and
(d) Distributions made by a Real Estate Investment Company to its shareholders from rental or dividend income received on behalf of those shareholders.

It should be noted that the exemption still applies whether or not where the profits that generated such dividend accrued in a year other than the year in which the dividend was paid.

Illustration 8.4
An extract from the financial statements of ABC Limited XYZ Limited for the year ended December 31, 2020, revealed the following:

	ABC Limited	**XYZ Limited**
	N	**N**
Total profit/(loss) for the year	3,600,000	(1,200,000)
Retained earnings brought forward	4,800,000	2,000,000
Dividend declared in 2020 paid in 2021	4,200,000	750,000

Based on the financial information disclosed for the companies, the following are to be noted:

(a) Out of the dividend of ₦4,200,000 paid by ABC Limited, only ₦600,000 can be regarded as having been paid out of retained earnings, hence only ₦3,600,000 shall be subject to the application of section 19(1) of CITA.

(b) ₦750,000 paid by XYZ Limited was not paid from the current year's loss, hence this amount will not be subject to the application of section 19(1).

8.7.4 Dividend distribution – Nigerian dividends received by companies other than Nigerian companies

When dividends are received by a company that is neither a Nigerian company nor engaged in a trade or business in Nigeria at any time during the year of assessment

(a) No tax shall be charged on it for that year in respect of the dividend received by it from Nigerian company apart from withholding tax; and

(b) Where any dividend is paid out of profit for which no tax is payable due to no total profit or total profit which are less than the amount of dividend which is paid, whether the recipient of the dividend is a Nigerian company or not, the company paying the dividend shall be charged to tax at the prevailing companies income tax rate as if the dividend is the total profits of the company for the year of assessment.

8.7.5 Undistributed profit of a Nigerian company deemed to be dividend

Any amount of undistributed profit of a Nigerian company which is treated as distributed under the provisions of any law in force in Nigeria imposing tax on the profits of companies shall be deemed to be income from a dividend accruing to any person who is a shareholder in the company in proportion to his share in the ordinary capital thereof at the relevant time, and the income for the dividend be taken for assessment in his hands shall be his due proportion thereof increased by such amount as may be specified by the relevant tax authority in respect of tax deemed to be deducted at source.

The income from a dividend distributed by a Nigerian company shall be deemed to arise on the day on which payment of that dividend becomes due.

8.8 Anti-abuse

Any attempt by a company to split the transactions that were carried out prior to the commencement of the Finance Act, amongst two or more companies in order to benefit from the exemption of profits of small companies, the Service in accordance with the provisions of section 22 of CITA, shall discountenance such splitting, and aggregate all such transactions to the company originally doing the business.

After the commencement of the Finance Act, 2019, any attempt by a taxable person to incorporate new companies or uses two or more companies to transact a business which in the opinion of the Service is aimed at benefitting from the tax exemption of profits of small companies, the value of such contracts shall be aggregated and taxed in the hand of one of the companies.

In line with section 42 of the FIRS Act, any company that conceals its turnover with a view to obtaining tax benefit available to small companies shall be prosecuted with its directors and relevant principal officers. Any tax liabilities arising from the foregoing, shall be recovered with penalties and interest.

8.90 Chapter review

This chapter examines the concept of total profit and its determination for the purpose of companies income tax computation. The chapter equally addresses the issue of applicable tax rates for companies income tax in line with classification of companies as provided in Finance Act, 2019.

The background to the introduction of tertiary education tax, its objectives and the method of computing the tax is also discussed.

Apart from the normal basis of companies income tax computation, the conditions for using other bases such as, minimum tax, revenue (gross turnover) and dividend bases are also fully covered .

The amendments made to minimum tax basis and dividend paid basis of companies income tax by Finance Act, 2019 and Finance Act, 2020 are also captured.

8.10 Worked examples

8.10.1 Open-ended Questions

(1) Empire Nigeria Limited is owned by Nigerians and has been in business since year 2003. The results of the company as at December 31, 2020 are as follows:

Assets employed	₦	₦
Non-current assets		180,000,000
Current assets	550,000,000	
Less: Current liabilities	360,000,000	
Net current assets		190,000,000
Net assets		**370,000,000**
Financed by:		
Share capital		140,000,000
Statutory reserves		60,000,000
General reserves		100,000,000
Long term loans		70,000,000
		370,000,000

You are provided with the following additional information:

(i) The revenue of the company during the year ended December 31,2020 was ₦240,000,000.

(ii) Gross profit was ₦35,000,000.

(iii) Assessable profit was ₦2,100,000.

(iv) Unrelieved capital allowances brought forward from 2020 year of assessment was ₦600,000.

(v) Capital allowances for 2021 year of assessment amounted to N950,000.

You are required to:

(a) Compute the company's minimum tax liability for 2021 year of assessment.
(b) Compute the company's income tax liability for 2021 year of assessment. Note: Ignore restriction on capital allowance that can be relieved.
(c) Differentiate between direct and indirect taxes. Explain three examples of each.

(2) The Managing Director of Boling Nigeria Limited attended a workshop during which he came across the following tax matters under the Companies Income Tax Act CAP C21 LFN 2004 (as amended):

(a) Classification of Nigerian companies based on the provisions of Finance Act, 2019 and Finance Act, 2020;
(b) Provisions of Finance Act, 2019 on dividend basis of companies income tax;
(c) Treatment of losses in the ascertainment of total profits; and
(d) Incentives, with particular reference to research and development.

On his return to the office, he requested the Finance Director to explain these tax matters to him. The Finance Director did his best to explain to the Managing Director but he was not satisfied with the Finance Director's explanation.

The Managing Director invited a Tax Consultant, whom he met at the workshop, to explain the four items.

As the Tax Consultant, you are required to explain the provisions of the Companies Income Tax Act CAP C21 LFN 2004 (as amended) with respect to the four areas of interest identified by the Managing Director.

(3) Conversion of Abia, Biodun, Clement & Co. to ABC Consultants Limited

Abia, Biodun and Clement based in Makurdi, Benue State, have run the firm Abia, Biodun, Clement and Company as builders for several years. The partnership agreement provided for the following:

(i) Salaries paid to partners:

		₦
Abia		120,000
Biodun		240,000
Clement		480,000
(ii) Profit sharing ratio: Abia		1/5
	Biodun	3/10
	Clement	1/2

In January 2010, there was a decision to review the partnership agreement. Messrs Abia, Biodun and Clement have been unable to find worthy successors to take over as partners. Rather than review the partnership agreement, they agreed to convert the partnership into a limited liability company. In view of this, a firm of Chartered Accountants was contacted to incorporate the name ABC Consultants Limited. The authorised share capital of the proposed company was agreed at ₦10,000,000, made up of 10,000,000 ordinary shares of ₦1.00 each. The details of the shareholding structure was agreed as follows:

Abia	20%
Biodun	30%
Clement	50%

The certificate of incorporation was approved by the Registrar-General of the Corporate Affairs Commission, Abuja on 1 August 2010. The Certificate of Incorporation was dated 10 August 2010. The company commenced business on October 1, 2010. The cost of incorporation include:

	₦
Payment for stamp duty	80,000
Professional fee for incorporation	50,000
Corporate Affairs Commission registration fees	100,000
Additional costs of incorporation	40,000
	270,000

The financial results for the year ended December 31,2010 are as follows:

	₦	₦	₦
Income			4,000,000
Less :			
Cost of incorporation		270,000	
Transport and travelling		135,000	
Medical		120,000	
Hotel and accommodation		125,000	
Audit and accountancy		110,000	
Postages and telephone		150,000	
Salaries:			
Abia	120,000		
Biodun	240,000		
Clement	480,000	840,000	1,750,000
Net profit	2,250,000		

Assume: Fees and expenses were earned/incurred evenly throughout the year.

You are required to write a report to Messrs Abia, Biodun & Clement, highlighting:

(a) Any one tax implication of the decision to convert to a limited liability company, limiting yourself to the facts/details provided in the case study.

(b) Your comment on the breakdown of the cost of incorporation of ₦270,000 and the tax implication of each item.

(c) Compass Holding Company (CHC) is essentially a holding entity that was only engaged in the treasury and finance operations of its four subsidiaries in Lagos State of Nigeria.

The following are extracts from its books of accounts in respect of the year ended December 31, 2011:

	₦'000
Net profit per accounts	107,000
Depreciation	18,500
Balancing charge	5,200
Donations	12,500
Capital allowances (unrestricted)	22,300
Diminution in value of investments	25,000
Profit on export sales	5,200
Loss relief	15,200
Bad debt provision	32,000

Additional notes:

(i) Profit from sale of property, plant and equipment included in the holding company's results for the year amounted to ₦60million.

(ii) Dividend income (net of withholding tax) from subsidiaries included in the holding company' s account amounted to ₦105million.

(iii) Dividend paid to shareholders of Compass Holding Company for the year was ₦165million.

As the tax consultant to the board of CHC, you are required to advise on the following:

(a) The tax implications of the dividend paid by the board.

(b) The tax liability of the company for the relevant assessment year.

8.10.2 Suggested solutions to open-ended Questions

(1) **Empire Nigeria Ltd.**

(a) **Computation of minimum tax liability for 2021 year of assessment**

	N
Turnover	**240,000,000**
Minimum tax thereon @0.25%	**600,000**

(b) **Computation of companies income tax liability**

2021 Assessment year

	₦	₦
Assessable profit		2,100,000
Deduct		
Unrelieved capital allowances b/f	600,000	
Current year capital allowance	950,000	(1,550,000)
Total profit		550,000
Companies income tax (30% of N550,000)		165,000
Tertiary education tax (2% of N2,100,000)		42,000
Total tax liability		207,000

(c) **Direct tax**

This is charged on a taxpayer's income, profits or other gains. They are paid by the taxpayer directly to the tax authority.

Indirect tax

This is tax on spending. The tax is charged when a taxpayer buys an item and is paid to the supplier as part of the purchase price of the item. The supplier passes the tax to the tax authorities.

Examples of these taxes are stated below:

Direct taxes	**Indirect taxes**
Personal income tax	Value added tax
Capital gains tax	Sales tax
Petroleum profits Tax	Customs and excise duties
Companies income tax	Goods and services tax Tertiary
education tax	Stamp duties
Withholding Tax	

(2) (a) **XYZ & Co. (Chartered Accountants)**

May 18, 2021

The Managing Director Boling
Nigeria Limited Airport Road
Ikeja, Lagos

Dear Sir,

RE: Tax Matters

Further to our discussions at the last workshop, please find below our explanations on the four areas of interest as identified by you.

(a) Classification of Nigerian Companies based on Finance Act, 2019 and Finance Act, 2020

The provisions of the Companies Income Tax Act (CITA) prior to commencement of Finance Act, 2019 was that all Nigerian companies are liable to the same Companies Income Tax (CIT) rate of 30% with exception of small businesses (i.e. companies with less than N1,000,000 turnover) that are taxed at reduced rate of 20%.

The Finance Act, 2019 has classified companies into various categories with different tax rates as follows:

Types of companies	**Basis of classification**	Applicable tax rate
Small companies	Annual turnover of ₦25,000,000 and below	0%
Medium-sized companies	Annual turnover of above ₦25,000,000 but less than ₦100,000,000	20%
Large companies	Annual turnover of ₦100,000,000 and above	30%

Implications of classification of Nigerian companies

The implications include:

- Small businesses are still required to register for tax, prepare audited financial statements and file tax returns as and when due;
- Small companies are no longer liable to withholding tax (WHT) on their income since WHT is an advance payment of income tax; and
- The Finance Act, 2020 stipulates that the Federal Inland Revenue Service (FIRS) may prescribe the form of accounts other than audited financial statements for small and medium size companies as defined under CITA.

(b) Provisions of Finance Act, 2019 on dividend basis of companies income tax

The Finance Act, 2019, introduced changes to limit the application of the tax only to untaxed profits that are not exempt from tax.

The implications of these amendments are that the following no longer count in the determination of excess dividend tax:

- Retained earnings on which adequate tax had previously been paid under CITA, PPTA or the CGTA;
- Exempt profits;
- Franked investment income;
- Dividend by a real estate investment companies (REICO) out of rental and dividend income;
- The year to which the profits relate is also now irrelevant; and
- The possibility of a company paying excess dividend tax is now limited.

(c) **Treatment of losses in the ascertainment of total profits**

In ascertaining the total profits of any company, losses are deductible from the total assessable profits from all sources. The conditions to be met for losses to be so deductible as contained in Section 31 of CITA CAP C21 LFN 2004 (as amended) are:

- The board must be satisfied that the loss has been incurred by the company in any trade or business during any preceding year of assessment;
- The aggregate deduction from the assessable profits or income must not exceed the amount of the loss;
- The loss can be carried forward and deducted from the same trade or business without restriction on period; and
- The loss sustained by a non-resident company that indigenizes its Nigerian operations shall be deemed to be a loss of the re- constituted company in its trade or business during the year of assessment in which it commenced business, and it shall be deducted from the profits of subsequent assessment year(s).

(d) **Tax incentives with particular reference to research and development:**

Section 26 (1), (2) and (3) stipulate that:

- In ascertaining the profits or loss of any company, from any source, chargeable to tax, there shall be deducted, the amount of reserve made out of the profits of that period by that company for research and development;
- The allowed deduction for research and development shall not exceed 10% of the total profits of the company for that Year of assessment; and
- Where the company or organisation is engaged in research and development for commercial purposes, the incentive is 20% investment tax credit of the qualifying expenditure.

We hope the above satisfies your enquiry. Please feel free to revert to us if you require any further clarification.

Yours faithfully,
For XYZ & Co.(Chartered Accountant)

James Patrick
Managing Partner

QUESTION 3

The Board of Directors
ABC Consultants Limited
2, Ajao Street
Lagos

Dear Sirs,

RE: Conversion of Abia, Biodun, Clement in partnership to ABC Consultants Limited

We write in response to your recent decision to convert your partnership business into a limited liability company. Please find below our submissions:-

(a) **Tax implications of conversion**

(i) The partnership ceases on September 30, 2010 and so all partnership income shall be based on personal income tax.

(ii) Commencement rules will apply from October 1, 2010 when ABC Consultants Limited commences operation.

(iii) The incorporation expenses shall be applicable only to ABC Consultants Limited though not an allowable expense for tax purposes.

(iv) ABC Consultants Limited will be required to register with the Federal Inland Revenue Service (FIRS) for the purpose of Companies Income Tax, Tertiary Education Tax, Value Added Tax, Withholding Tax and other taxes due from the company to FIRS.

(v) ABC Consultants Limited in accepting the incorporation expense, shall deduct and remit with-holding tax from the Professional fees at the rate of 10% if the beneficiary is a company and 5% if the recipient is an individual partnership or incorporated entity.

(b) **Tax implications of cost of incorporation**

(i) The total cost of N270,000 though paid during the partnership period, shall be considered as pre-operational expenses ofABC Consultants Limited.

(ii) The pre-operational expenses when added back, will increase taxable income, thereby increasing tax payable by ABC Consultants Limited.

(iii) ₦270,000 charged into ABC Consultants Limited is not an allowable expense for tax purposes even if spread over a number of years.

Yours faithfully,
For ABC Consultants Limited

D. Mohammed Managing Consultant

(i) Based on the above provision, it is evident that the dividend paid (₦165,000,000) is more than the total profit (NIL). It would appear that what was paid as divided was the dividend income of ₦105,000,000 and the profit from sale of property, plant and equipment of ₦60,000,000.

(ii) However, there is a provision of the Act (CITA) section 80(3) which stipulates that dividend income from subsidiaries of a holding company (net of withholding tax), is regarded as franked investment income and therefore regarded as final tax in the hands of the recipients.

(iii) Based on point noted above, the dividend income (₦105,000,000) is not to be subjected to further tax..

(iv) The balance of ₦60,000,000 representing the profit from sale of property, plant and equipment is already included in the income of the holding company and at the time of redistribution of the dividends to the shareholders of Compass Holding, the dividends would not be subjected to further tax.

(v) Compass Holding Company, therefore, is expected to gross-up the dividends from its subsidiaries and offset the withholding tax suffered at source against the withholding tax deductible on distribution to the shareholders.

In our opinion, the only tax payable is the tertiary education tax of ₦496,000.

Should you require further clarification on any of the issues highlighted above, please do not hesitate to contact us.

We use this opportunity to thank you for your patronage.

Yours faithfully,
XYY & CO.

M. Ariyo Managing Partner

(b) **Compass Holding Company (CHC)**

Computation of tax liability for 2012 tax year

	₦'000	₦'000
Net profit per accounts **Add back:**		107,000
Depreciation	18,500	
Donations	12,500	
Diminution in investment	25,000	
Bad debt provision	32,000	88,000
		195,000
Less:		
Profit on export sales	5,200	
Profit from sales of property, plant and equipment	60,000	
Dividend treated as franked investment Income	105,000	170,200
Assessable profit		24,800
Add: Balancing charge		5,200
		30,000
Less: Loss relief		15,200
		14,800
Less: Capital allowance	22,300	
Limited to 2/3 of ₦24,800	14,800	14,800
Unabsorbed capital allowances c/f	7,500	
Total profit		NIL
Tax payable (Please see comment a(i) above)		NIL
Tertiary education tax payable =	**496,000**	

9

Special businesses

Contents

9.0 Purpose

At the end of this chapter, readers are expected to know:

The procedure for assessing businesses in shipping or air transport/ courier services;

(a) The procedure for assessing Nigerian life assurance businesses;

(b) The procedure for assessing non-Nigerian life assurance businesses;

(c) The procedure for assessing non-life Nigerian businesses; and

(d) The procedure for computation where a business is into life and non-life transactions.

(e) How banks are subjected to tax in Nigeria

(f) The procedures for assessing unit trust scheme

(e) The provisions of Finance Act, 2019 on taxation of real estate investment companies

(f) The Implications of the Finance Act, 2019 on operation of the regulated securities lending transactions in Nigeria

9 .1 Introduction

Companies Income Tax Act (CITA) contains special provisions with regards to companies engaged in shipping or air transport business as well as those in wireless telecommunication and insurance business. The provisions below are additional to the normal rules of allowable and disallowable expenditure in taxation practice.

Also, the Finance Acts 2019 and 2020 introduced some amendments to CITA with respect to taxation of insurance business, estate companies and real estate investment companies as well as regulated securities lending transaction. These are covered in this chapter.

9 .2 Shipping or air transport/courier companies

[Non-Nigerian Companies] CITA Section 14 contains provisions regarding companies, other than Nigerian companies, in shipping or air transport business. The substance of that Section is as follows:

(a) The profits or losses of such company deemed to be derived from Nigeria is the full profits or losses arising from the carriage of passengers, mails, livestock or goods shipped, or loaded into an aircraft, in Nigeria. This does not apply to passengers, mails, livestock or goods which are brought into Nigeria solely for trans- shipment or for transfer from one aircraft to another or in either direction between an aircraft and a ship.

To the sums receivable in respect of passengers, etc. carried in Nigeria as referred to above, there shall be applied the following:

(i) The ratio of profits or losses of an accounting period, before depreciation, to the total sums receivable in respect of the business of the company, and

(ii) The ratio of depreciation to the total sums receivable as certified by the tax authority of any other country (where the Non-Nigerian company is registered) to the satisfaction of the Revenue Service. This ratio shall be applied on the Nigerian income to arrive at the capital allowance for the relevant tax year.

The amount arrived at shall be the full profits or losses which shall be liable to Nigerian tax.

Note that this situation will apply where the Revenue is satisfied that the tax authority of any other country computes and assesses on a basis not materially different from that prescribed by the CITA of Nigeria:

(a) Where the ratios referred to above cannot, for any reason, be satisfactorily applied, the profits 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, etc. shipped or loaded in Nigeria. When this occurs, the company has within six years to claim that its liability be recomputed on the basis of the ratios referred to above; and

(b) If the company fails to agree with the Revenue Service, the Revenue Service shall give notice to the company of refusal to admit the claim and the provisions of CITA with respect to objections and appeals shall apply accordingly with any necessary modifications.

However, where there is agreement on the two ratios and the Nigerian Tax Authority is convinced that Nigerian companies enjoy similar treatment in the country of the foreign company, the understated procedure shall be adopted to subject the company to tax.

The procedure is:

i) Determine the global income by aggregating all the incomes of the particular company in the relevant year of assessment;

ii) Determine the Nigerian income i.e. income on goods, mails, passengers, etc shipped or carried out of Nigeria;

iii) Compute the global adjusted profit (GAP) by applying the principle of trading profit adjustment, treating allowable and disallowable items of income and expenses;

iv) Compute the global adjusted profit ratio using this formula;

$$\frac{\text{Global adjusted Profit} \times 100}{\text{Global Income} \times 1}$$

v) Compute the depreciation ratio using this formula:

$$\frac{\text{Depreciation Expenses charged in the accounts} \times 100}{\text{Global Income} \times 1}$$

vi) Compute Nigerian Adjusted Profit thus:

GAP Ratio x Nigeria Income

vii) Compute capital allowance relief thus:

Depreciation Ratio x Nigerian Income

viii) Determine the total profit;

	₦
Nigerian Adjusted Profit	xx
Less Capital allowance relief	(xx)
Total profit	xx

ix) Determine tax payable by applying the tax rate on the total profit in "viii" above

Illustration 9.1:

The statement of comprehensive income of Kukute Oriogan Airways, a company Incorporated in Germany in 2015 shows the following in respect of the year ended 31st December, 2017.

	₦	₦
Income from passenger freight Out of Nigeria	300,000	
Income from passenger freight into Nigeria	1,000,000	
Income from passenger freight on other routes	3,600,000	4,900,000
Deduct:		
Administration expenses	1,620,000	
Financial expenses	340,000	
Depreciation	588,000	
Other disallowable expenses	180,000	2,728,000
Net profit for the year		2,172,000

The Federal Inland Revenue Service is satisfied that the tax authority of Germany computes and assesses the profit of companies operating air crafts on substantially similar basis as Nigeria.

Required:
Calculate the tax payable for the relevant tax year.

Solution to Illustration 9.1

Kukute Oriogan Airways

Computation of tax payable for 2018 tax year

		₦	₦
1.	Global income		4,900,000
2.	Nigerian income		300,000
3.	Computation of global adjusted profit (GAP)		

Net profit per accounts			2,172,000
Add: Depreciation			588,000
Other disallowable expenses	180,000	768,000	
		2,940,000	

4. Computation of global adjusted profit ratio:

$$\frac{\text{GAP}}{\text{GLOBAL INCOME}} \quad x \quad \frac{100}{1}$$

$$\frac{2,940,000}{4,900,000} \quad x \quad \frac{100}{1} \quad = \quad 60\%$$

5. Computation of depreciation relief ratio:

$$\frac{\text{Depreciation}}{\text{Global income}} \quad x \quad \frac{100}{1}$$

$$\frac{558,000}{4,900,000} \quad x \quad \frac{100}{1} \quad =12\%$$

6. Nigerian adjusted profit:

60% of N300,000 = ₦180,000

7. Capital allowance

12% of ₦300,000 = ₦36,000

8. Taxable profit:

	₦
Nigerian adjusted profit	180,000
Less capital allowance	36,000
Total Profit	144,000
Tax payable @ 30%	₦43,200

Illustration 9.2

The statement of comprehensive income of a foreign Airline – Aifel Airways operating from France for the year ended 31st March 2017 is as follows:

	₦	₦
Income from passenger freight into Nigeria		600,000
Income from goods loaded into aircraft in Nigeria		440,000
Income from passengers freight out of Nigeria		360,000
Income from goods into aircraft on other routes		1,000,000
		2,400,000
Less: Salaries and other expenses	1,600,000	
Depreciation	240,000	
Other disallowable expenses	80,000	1,920,000
Net profit for the year		480,000

You are given the following additional information:

i) The Federal Board of Inland Revenue has agreed to allow the company to claim the amount charged as depreciation in the accounts in lieu of capital allowance.

ii) Salaries and other expenses include:

a) Deposit for a new DC air aircraft 160,000

b) Payment for VIP lounge at the international airport, Kaduna to Nigeria Airport Authority ₦24,000c) Payment of 12,000 of rent for accommodation used as transit flat by the airline crew:

Required:
Prepare a statement showing;

i) The total profit for Nigerian tax purpose

ii) Income tax payable by the airline for the relevant year of assessment (Tax rate 30%)

Solution to Illustration

9.2 Aifel Airways

Total profit and income tax payable for 2018 year of assessment

i) Global income ₦2,400,000

ii) Income from Nigeria (440,000 + 360,000) ₦800,000

iii) Global adjusted profit computation

	₦	₦
Net profit per account		480,000
Add; i) Depreciation	240,000	
ii) Other disallowable expenses	80,000	
iii) Deposit for new aircraft	160,000	
	480,000	
Global adjusted profit		960,000

iv) Computation of global adjusted profit (GAP) Ratio;

$$\frac{\text{GAP}}{\text{GLOBAL INCOME}} \times \frac{100}{1}$$

$$\frac{₦960,000}{₦2,400,000} \times \frac{100}{1} = 40\%$$

v) Computation of Nigerian adjusted profit:

GAP Ratio x Nigerian income

= 40% x ₦800,000

= ₦320,000

vi) Capital allowance granted in lieu of depreciation ₦240,000

vii) Computation of total profit:

	₦
Nigerian adjusted profit	320,000
Less: capital allowance	240,000
Total profit	80,000
Tax payable as at 30%	₦32,000

From the 1988 assessment year, sub-section (4) was added to Section 12 to the effect that the tax payable for any year of assessment shall not be less than 2% of the full sums receivable in respect of the carriage of passengers, mails, livestock or goods shipped or loaded into an aircraft in Nigeria.

9 .3 Taxation of insurance companies

a) Introduction

The taxation of insurance business is covered by Sec 14 of CITA 2007. The section deals with both Nigerian and Non-Nigerian insurance businesses. It further distinguishes between life assurance business and non-life insurance business.

For tax purposes, the main difference between the taxation of life assurance business and non-life business is that for life assurance business, the premium received from the assured does not form part of income for tax purposes since the assured will definitely be paid or indemnified either at his death or the attainment of a specified age under endowment policy. Since the premium is not taken as income, claims paid is also not allowable as a deduction for life assurance business, the reverse is applicable for non-life insurance business.

With effect from 1995, where a company engages in composite insurance business, that is, a company carrying on life and non-life insurance business, the income from each source would be taxed separately. This means that where a loss is incurred from life business, it cannot be relieved against income from non-life.

Like any other company, dividend received by insurance companies is treated as Franked investment income and they are exempted from tax. The investment income does not include premium received from the assured. It is made up of dividend(to be exempted), interest, annuities, commission received, rent as well as surplus arising from actuarial revaluation of the reserve for the unexpired risk account or life fund account transfer to the profit and loss account for distribution.

(b) Determination of assessable profit and tax liability of life business

(i) **Nigerian company:** The assessable profit and tax liability of a Nigerian company carrying on life insurance business is determined as follows:

	₦	₦	₦
Investment income			xx
Other income			xx
Actuarial revaluation surplus distributed			xx
Gross income			xx
	₦	₦	₦
Deduct:			
• i. General reserves	Xx		
Add life fund a/c	Xx	xx	
less net liabilities on policies	(x)	x	

ii. Special reserve The higher of:			
1 % of gross premium OR	x		
10% of net profit	x	x	
iii. Other allowable management expenses		x	(x)
Assessable profit			**xx**
Less capital allowance			(x)
Total profit			x

Tax payable shall be the higher of:
Tax paid as per total profit computed; and
Tax paid on 0.5% of gross income

Notes:
Annual transfer to special reserves would depend on whether the total reserves are equal to or higher than the minimum statutory paid up capital.

Also, the above minimum tax of 0.5% on gross income has been reduced to 0.25% on gross income for tax returns prepared and filed for any year of assessment falling due on any date between January 1, 2020 and December 31, 2021, both days inclusive.

(ii) **Non-Nigerian company:** The assessable profit of anon- Nigerian company carrying on life assurance business is determined as follows:

	₦	₦
Investment income (see working1)		x
Less Agency commission in Nigeria	x	
Allowable expenses in Nigeria	x	
Fair proportion of head office expenses	x	(x)
Assessable profit		x

Working

Investment income:

$$\frac{\text{Premium receivable in Nigeria}}{\text{Global premium receivable of the company}} \times \frac{\text{Global investment income}}{1}$$

(c) **Non-life insurance business**

Nigerian Company: The assessable profit and tax liability ofa Nigerian company carrying on non-life insurance business is determined as follows:

(d) **Non-life insurance business**

(i) Nigerian company: The assessable profit and tax liability of a Nigerian company carrying on non-life insurance business is determined as follows:

	₦	₦	₦
Gross premium			x
Less premium returned on cancelled policies			(x)
Net premium			xx
Add:			
Investment income		x	
Fees and commission income		x	
Rent received		x	
Estimated insurance claims for previous year, for example, re-insurance claims		x	x
Gross income			xx
Less non-taxable income (if any)			(x)
Net income			xx
Less:			
Reserve for unexpired risk calculated on time apportionment basis		x	
Re-insurance premium paid		x	
Commission		x	
Other allowable management expenses		x	
Insurance claims and outgoings:			
Actual total claims expenses (a)	x		
Add estimated total claims expenses (b)	x		
Total claims and outgoings claimable (a + b)	x	x	(x)
Assessable profit			**xx**
Less loss b/f (if any)			x
			xx
Add balancing charge (if any)			x
			xx
Less capital allowance			(x)
Total profit			**xx**

Tax payable shall be the higher of:
Tax @ specified rate of total profit computed, taking into consideration the gross premium ; or
Tax on 0.5% of gross premium

Notes:

- Under non-life business, any unutilised part of both the actual and the estimated claims and outgoing expenses in any year, shall be added back to the profits of the following year.
- The above minimum tax of 0.5% on gross premium has been reduced to 0.25% of gross income for tax returns prepared and filed for any year of assessment falling due on any date between January 1, 2020 and December 31, 2021, both days inclusive.

(ii) **Non-Nigerian company:** Where a non-Nigerian company engaged in non-life insurance business in Nigeria, the assessable profit would be determined just like that of the Nigerian company. However, only premium received in Nigeria will be taken into consideration. Also, only expenses incurred in Nigeria will be allowed as deduction including a fair proportion of Head Office expenses.

For a Non-Nigerian insurance company to be liable to tax in Nigeria, it must have a permanent establishment in Nigeria. "Permanent establishment" in relation to an insurance company means a branch, management or a fixed place of business
in Nigeria, but does not include an agency in Nigeria unless the agent has, and habitually exercises a general authority to negotiate and conclude contracts on behalf of such company.

Where an insurance company carries on a life class and a general class insurance business, the funds and books of account of one class shall be kept separate from the other as though one class does not relate to the other class and the annual tax returns of the two classes of insurance business be made separately.

For each class of insurance business, where there are more than one type of insurance (products) in the same class, they form one type of business and the loss of one shall be allowed against the income from another type of insurance business but the loss shall be available to be carried forward against profit from the same class of insurance business, and such loss can be carried forward for a maximum of 4 years.

(e) **Reinsurance business**

The assessable profit and tax liability of a company carrying on reinsurance business is determined as follows:

	₦	₦	₦
Gross premium			x
Less premium returned on cancelled policies			(x)
Net premium			xx
Add:			
Investment income		x	
Fees and commission income		x	
Rent received		x	

Estimated insurance claims for previous year, for example, re-insurance claims		x	xx
Gross income			xx
Less non-taxable income (if any)			(x)
Net income			xx
Less:			
Reserve for unexpired risk calculated on time apportionment basis		x	
Re-insurance premium paid		x	
Commission		x	
Other allowable management expenses		x	
Insurance claims and outgoings:			
Actual total claims expenses (a)	x		
Add estimated total claims expenses (b)	x		
Total claims and outgoings claimable (a + b)	x	x	(x)
			xx
Add: Transfer to general reserve			
(i) General reserve < minimum authorised Capital 50% of gross profit	x		
Or			
(ii) General reserve ≥ minimum authorised capital			
Restricted to 25% of gross profit	x		(xx)
Assessable profit			xx
Less loss b/f (if any)		x	
Relief		x	x
		x	xx
Add balancing charge (if any)			x
			xx
Less capital allowance		(x)	x
Total profit			**xx**

Tax payable shall be the higher of:
Tax @ specified rate of total profit computed, taking into consideration the gross income; or
Tax paid on 0.5% of gross premium

Notes:

- Under re-insurance business, any unutilised part of both the actual and the estimated claims and outgoing expenses in any year, shall be added back to the total profits of the following year.
- The above minimum tax of 0.5% has been reduced to 0.25% for tax returns prepared and filed for any year of assessment falling due on any date between January 1, 2020 and

December 31, 2021, both days inclusive.

(f) **Additional information to be filed or records to be kept by insurance business**

An insurance company that engages the services of an insurance agent, a loss adjuster and an insurance broker shall include in its annual tax returns, a schedule showing the names and addresses of insurance agents, loss adjusters and an insurance brokers, the dates their services were employed and terminated and payments made to them.

An insurance company shall maintain details and schedule of policies or risks accepted in a given year and the computation of un-expired risks associated with them. The schedule should include the name of the policy holder, type of policy, period of the policy, amount of the premium and expired risk computed there from.

A schedule detailing the specific items making up the estimated amount of outstanding claims and outgoings shall be prepared, by insurance companies.

Insurance companies shall maintain a schedule of estimated claims and outgoings that constitute the amount deducted every year.

(g) **Recent changes introduced by Finance Act, 2019 and Finance Act, 2020**

(i) Definitions

- ❖ **Investment income - section 16(6) of CITA (as amended)**
  "Investment income" for the purpose of taxation of a life insurance company means "income derived from investment of shareholders' funds".

- ❖ **Gross premium and gross income – section 16(13) of CITA (as amended)**
  For the purpose of section 16(12) – minimum tax computation:
  - ❖ "Gross premium" means "the total premiums written, received and receivable excluding unearned premium and premiums returned to the insured"; and
  - ❖ "Gross income " means "total income earned by a life insurance business including all investment income (excluding franked investment income), fees, commission and income from other assets but excluding premium received and claims paid by reinsurers".

  Gross income may also include other incomes, such as annuities, commission received, rent, as well as surplus arising from actuarial revaluation of the reserve for the unexpired risk account or life fund account transferred to profit or loss account for distribution.

(ii) Minimum tax payable

Section 16(12) of CITA (as amended), provides that the tax payable by any insurance company for any year of assessment shall not be less than:

- 0.5% of the gross premium for non-life insurance business; and
- 0.5% of gross income for life insurance businesses.

Provided, that all applicable minimum tax under this section shall be reduced to

0.25% for tax returns prepared and filed for any year of assessment falling due on any date between January 1, 2020 and December 31, 2021, both days inclusive.

(iii) Losses can be carried forward indefinitely

Section 16(7) of CITA (as amended), allows insurance companies to carry forward losses indefinitely.

(iv) Others

- ❖ Based on section 16(8) of CITA (as amended), any insurance company other than a life insurance company shall be allowed for deductions from its premium, the following reserves for tax purposes:

- ❖ Reserve for unexpired risks calculated on a time apportionment basis of the risks accepted in the year instead of the old basis determined on a percentage consistently adopted by the company; and

- ❖ Outstanding claims and outgoings, an amount equal to the total estimated amount of all outstanding claims and outgoings, provided that any amount not utilised towards settlement of claims and outgoings shall be added to the total profits of the following year instead of the old provision which was based on a percentage (25%) of total premium.

- ❖ Based on section 16(9)(c) of CITA (as amended), a life insurance business shall now deduct all normal allowable business outgoings from its investment income and other incomes, and no restriction on a certain percentage (20%) of gross income shall be available as total profit of the company for tax purposes.

Illustration 9.1

An extract from the financial statement of Insurance PLC for the year ended December 31, 2020 shows the following:
Reserve for un-expired risk brought forward from 2019 - ₦2,000,000
Reserve for expired risk as at December 31, 2020 - ₦5,000,000
The un-expired risk that is attributable to the risk accepted in the year is ₦3,000,000 (₦5,000,000 - ₦2,000,000).

<u>Estimated Amount of Outstanding Claims and Outgoings</u>

The amendment allows for an estimated amount of outstanding claims and outgoings during a given year, thereby repealing the old provision which was based on a percentage of total premium.

The amount of the estimated outstanding claims include verified but unpaid claims and an estimate for unverified claims received for the accounting period. The amount of estimated claims and outgoings made in one year shall be allowed as a deduction in that same year and added to the assessable profits of the immediate following year. As such, any shortfall or excess of estimated claims and outgoings is adjusted for.

NOTE:
Estimated amount of outstanding claims and outgoings must be supported with detailed schedule of specific items making up the total.

Illustration 9.2
An extract from the tax returns of XYZ Ltd. for YOA 2020 and 2021 show the following:

	2020	**2021**
	₦	**₦**
Estimated claims and outgoings	7,000,000	3,500,000
Actual claims and outgoings for the year	4,000,000	5,000,000
Net Profit before claims	12,000,000	9,500,000

The assessable profits are computed as follows:

	₦	**₦**
For 2020 year of assessment:		
Net Profit	12,000,000	
Less: Actual claims and outgoings	4,000,000	
Estimated claims and outgoings	7,000,000	11,000,000
Assessable Profit		**1,000,000**

For 2021 year of assessment:

Net Profit		9,500,000
Add: Estimated claims and outgoings (2020)		7,000,000
		16,500,000
Less: Actual claims and outgoings	5,000,000	
Estimated claims and outgoings (2021)	3,500,000	8,500,000
Assessable Profit		**8,000,000**

NOTE:
Insurance companies should maintain a schedule of estimated claims and outgoings that constitute the amount deducted every year.

<u>Minimum Tax Computation for Non-Life Insurance Business</u>
Section 16 (12)(a) of CITA, prescribes a fixed percentage of 0.5% of the gross premium as minimum tax for non-life insurance business.

<u>Gross Premium</u>

For the purposes of minimum tax, the gross premium for non-life business is the total of premium received and receivable (excluding premium returned to the insured) before any other deduction whatsoever.

Illustration 9.3
ABC Insurance PLC has the following extract from its financial statement for the period 2019:

Total Premium Written 11,000,000

Premium Paid on Reinsurance	2,000,000
Premium Returned to Insured	1,000,000

Compute the Minimum tax payable

Solution:		**₦**
Gross Premium Written		11,000,000
Less: Premium Returned		1,000,000
Gross Premium Liable to Min. Tax	**10,000,000**	
Min. Tax. = 0.5% x 10,000,000	**50,000**	

(h) Format for Computing Non-Life Insurance Business Tax

This format may be used as a guide for the computation of CIT of Non-Life Insurance Businesses.

	₦	₦
TOTAL PREMIUM WRITTEN		XXXXXXXX
LESS: PREMIUM RETURNED (CANCELLED INSURANCE POLICIES)		XXX
NET PREMIUM		**XXXXXXX**
ADD:		
ESTIMATED INSURANCE CLAIMS FOR PREVIOUS YEAR (IF ANY)	XXXXXXX	
INVESTMENT INCOME	XXXXXXX	
FEES AND COMMISSION	XXXXXXX	
RENT RECEIVED	XXXXXXX	
OTHER INCOME	XXXXXXX	XXXXXXX
NET INCOME		**XXXXXXX**
LESS: NON-TAXABLE INCOME (**IF ANY)**		(XXXXXXX)
NET TAXABLE INCOME		**XXXXXXXX**
LESS:		
RE-INSURANCE PREMIUM PAID	XXXXXX	
RESERVE FOR UNEXPIRED RISK	XXXXXX	
TAX ALLOWABLE OUTGOINGS	XXXXXX	
INSRUANCE CLAIMS: - ACTUAL FOR THE YEAR	XXXXXX	
- ESTIMATED FOR THE YEAR	XXXXXX	(XXXXXX)
ASSESSABLE PROFIT		**XXXXXXXX**
LESS: LOSS BROUGHT FORWARD (IF ANY)		XXXXXX
		XXXXXXXX
ADD BALANCING CHARGE		XXXXXXX
LESS: CAPITAL ALLOWANCES		XXXXXXX
TOTAL PROFIT		**XXXXXXXX**

COMPANIES INCOME TAX @ 30% OF TOTAL PROFIT (A) XXXXXXXX

MINIMUM TAX @ 0.5% OF GROSS PREMIUM (B) XXXXXXX

COMPANIES INCOME TAX IS THE HIGHER OF (A) and (B) XXXXXXXX

(i) **Life assurance business**

A "new subsection 16(6)" was inserted into CITA which defines "**investment income"** as *"income derived from investment of shareholders' funds".*

A new subsection 16(12) was also introduced into the Act which prescribes a fixed percentage of 0.5% of **gross income** as minimum tax for a life assurance business.

(j) **Gross income**

For the purposes of minimum tax computation, gross income of company engaged in life assurance business includes all investment income, fees, commissions and income from other sources or assets.

(k) **Format for Nigerian life assurance business tax computation**

Based on the new provisions introduced in the amendment, this format may be used as a guide for the computation of CIT payable by Life Insurance Businesses.

	₦	₦
INVESTMENT INCOME		**XXXXXXX**
ADD:		
FEES AND COMMISSION INCOME	XXXX	
DIVIDEND DISTRIBUTION OF ACTURIAL OR OTHER REVALUATION	XXXX	
ANY OTHER INCOME	XXXX	XXXXX
GROSS INCOME		**XXXXXXX**
LESS:		
GENERAL RESERVE FUND:	XXXXX	
SPECIAL RESERVE FUND – THE HIGHER OF:	-	
1% OF GROSS PREMIUM XXXXX	-	
10% OF TOTAL PROFIT XXXXX	XXXXX	
TAX ALLOWABLE NORMAL BUSINESS OUTGOINGS	XXXXX	(XXXXX)
		(XXXXX)
ASSESSABLE PROFIT		**XXXXXX**
ADD BALANCING CHARGE		XXXXX
LESS: CAPITAL ALLOWANCES		(XXXXX)
TOTAL PROFITS		XXXXXXX

COMPANIES INCOME TAX @ 30% OF TOTAL PROFIT (A)		**XXXXXXX**
MINIMUM TAX @ 0.5% OF GROSS INCOME (B)		**XXXXXXX**
COMPANIES INCOME TAX IS THE HIGHER OF (A) and (B)		**XXXXXXX**

illustration

Zen Insurance Co. Plc is a company engaged in both life and other insurance businesses. The draft IFRS account of the company for the year ended December 31,2020, disclosed the following information:

(a) **Statement of profit or loss**

For year ended December 31, 2020

	Life business	**Non-life Business**	**Reinsurance business**	**Total**
	₦'000	**₦'000**	**₦'000**	**₦'000**
Gross premium written	22,000	150,000	78,000	250,000
Gross premium income	22,000	150,000	78,000	250,000
Re-insurance premium	0	(58,000)	0	(58,000)
Net premium income	22,000	92,000	78,000	172,000
Fees and commission income	2,500	6,300	4,200	13,000
Net underwriting income	24,500	98,300	82,200	135,000
Claims expenses	(12,500)	(24,000)	(21,000)	(57,500)
Re-insurance claims	6,000	15,000	0	21,000
Change in contract liabilities	700	(2,300)	0	(1,600)
Net claims expenses	(5,800)	(11,300)	(21,000)	(38,100)
Underwriting expenses:				
Acquisition expenses	(300)	(1,400)	(990)	(2,690)
Maintenance expenses	(1,550)	(4,330)	(1,800)	(7,680)
Total underwriting expenses	(1,850)	(5,730)	(2,790)	(10,370)
Underwriting profit/(loss)	16,850	81,270	58,410	156,530
Investment income	5,800	12,600	13,700	32,100
Other operating income	1,800	3,800	2,400	8,000
Total investment income	7,600	16,400	16,100	40,100
Impairment charges	(450)	(1,330)	(1,080)	(2,860)
Net fair value gain / loss on investment properties	220	680	340	1,240

Net operating income	7,370	15,750	15,360	38,480
Expenses:				
Administrative expenses	(3,900)	(18,000)	(9,500)	(31,400)
Other operating expenses	(880)	(1,100)	(1,420)	(3,400)
Total expenses	(4,780)	(19,100)	(10,920)	(35,800)
Result of operating activities	19,440	77,920	62,850	160,210
Interest expenses	(3,600)	(7,500)	(4,800)	(15,900)
Profit or (loss) before taxation	15,840	70,420	58,050	73,310

(b)

Statement of financial position
For the year ended December 31, 2020

	Life Business	**Non-life business**	**Reinsurance Business**	**Total**
	₦	**₦**	**₦**	**₦**
Assets:				
Cash and cash equivalent	900,000	1,660,000	1,220,000	3,780,000
Financial assets	1,600,000	2,800,000	2,300,000	6,700,000
Trade receivable	28,000	52,000	44,000	124,000
Other receivables	1,400	4,600	750	6,750
Investment in subsidiary	0	3,500	0	3,500
Intangible assets	22,000	14,900	26,000	62,900
Property, plant and Equipment	1,200,000	3,550,000	2,400,000	7,150,000
Statutory deposits	300,000	500,000	400,000	1,200,000
Total assets	4,051,400	8,585,000	6,390,750	19,027,150
Liabilities:				
Insurance contracts Liabilities	1,300,000	5,280,000	1,520,000	8,100,000
Investment contract Liabilities	800,000	1,180,000	1,020,000	3,000,000
Trade payable	11,200	18,800	16,000	46,000
Other payables	600	1,200	130	1,930
Employee benefit Liabilities	520	680	550	1,750
Total liabilities	2,112,320	3,480,680	2,556,680	11,149,680
Equity				
Issued and paid-up				

share capital	1,200,000
Share premium	1,800,000
General reserve	2,600,000
Contingency reserve	400,000
Retained earnings	1,877,470
Shareholders' funds	7,877,470
Total liabilities and reserves	**19,027,150**

Additional information:

(i) The company distributed ₦ 3,500,000 surplus arising from actuarial revaluation of life fund.

(ii) Administrative expenses include depreciation:

Life business	Non-life business	Reinsurance business
₦'000	**₦'000**	**₦'000**
960	1,200	1,050

(iii) Premium written from non- life business and reinsurance business include ₦ 15,000,000 and ₦13,600,000 from general insurance.

(iv) Net liability on life policies as at December 31, 2020, was ₦1,298,000.

(v) Capital allowances agreed with the relevant tax authority are as follows:

Life business	Non-life business	Reinsurance business
₦'000	**₦'000**	**₦'000**
250	800	650

(vi) Investment income includes:

	Life business	Non-life business	Reinsurance business
	₦'000	**₦'000**	**₦'000**
Dividend (gross)	1,200	3,000	5,500
Interest on fixed Deposit	3,300	7,600	6,900
Debenture interest	1,300	2,000	1,300
	5,800	12,600	13,700

(vii) The provision for unexpired risk includes:

	Life business	Non-life business	Reinsurance business
	₦'000	**₦'000**	**₦'000**
Balance b/f	900	3,000	1,220
Balance c/f	1,300	5,280	1,520

(viii) The balance of the life fund account as at December 31, 2012, was ₦1,100,000.

(ix) The minimum authorised capital of the company is the same as the paid up capital.

(x) The estimated claims and outgoings omitted in arriving at the profit before tax for the year is as detailed below:

	Life business	**Non-life business**	**Reinsurance business**
	₦'000	**₦'000**	**₦'000**
Estimated claims	14,500	35,000	30,500
	14,500	35,000	30,500

Required:
Compute the company's tax liability for the relevant tax year.

(1) **Zen Insurance Co. Plc**
Computation of tax liability For 2021 assessment year

(a) Life business

	₦'000	**₦'000**	**₦'000**
Investment income:			
Interest on fixed deposit		3,300	
Debenture interest		1,300	4,600
Other income:			
Fees and commission income			2,500
Other operating income			1,800
Actuarial revaluation surplus distributed			3,500
Gross income			12,400
Deduct:			
(i) General reserves	2,600		
Add life fund a/c	1,100		
Total of general reserve and life fund.	3,700		
Net liability on policies	1,298		
:. Amount claimable restricted to			
maximum of net liabilities on policies.	1,298	1,298	
(ii) Special reserve			
The higher of:			
1% of gross premium – ₦ 22,000 x 1% or	220		
10% of net profit – ₦ 15,840 x 10%	1,584	1,584	
(iii) Other allowable management expenses:			
Administrative expenses- (N3,900 – N960)	2,940		
Interest expense	3,600		
Other operating expenses	880	7,420	(10,302)
Assessable profit			2,098
Less: Capital allowance			250

Total profit	1,848
Tax payable shall be the higher of:	
(a) Tax @ 0% on total profit or	N0.00
(b) Tax paid on 0.25% of gross income - Not applicable	N0.00
:. Tax payable is (a)	N0.00

Education tax @ 2% of assessable profit - Not applicable N0.00

(b) Non-life business

		₦'000	₦'000	₦'000
Premium written			150,000	
Less:				
Premium returned on cancelled policies			(0)	
Re-insurance premium			(58,000)	
Gross premium				92,000
Add:				
Interest income:			7,600	
Fees and commission income			6,300	
Other investment income – Debenture interest			2,000	
Other income			3,800	
Re-insurance claim			15,000	34,700
Gross income				126,700
Less: Reserve for unexpired risk calculated on time apportionment basis (N5,280-N3,000)				(2,280)
				124,420
Less Allowable expenses:				
Administrative expenses				
- (₦ 18,000 – ₦ 1,200)		16,800		
Other operating expenses		1,100		
Actual total claims expenses	24,000			
Add: Estimated total claims	35,000			
Total claims and outgoings claimable	59,000.	59,000		
Interest expense		7,500		(84,400)
Assessable profit				40,020
Less :Capital allowance				800
Total profit				39,220
Tax payable shall be the higher of:				

Tax paid as per total profit computed	
₦ 39,220,000 x 30% or	11,766,000
Tax paid on 0.25% of gross premium	
₦ 92,000,000 x 0.25%	230,000
Therefore, tax payable is	**N11,766,000**
Education tax @ 2% of AP (N40,020,000 x 2%)	**N 800,400**

(c) Reinsurance business:

	₦'000	₦'000	₦'000
Gross premium		78,000	
Less : Premium returned on cancelled policies		(0)	
Net premium			78,000
Add:			
Interest income:		6,900	
Fees and commission income		4,200	
Debenture interest		1,300	
Other operating income		2,400	14,800
Gross income			92,800
Less: reserve for unexpired risk calculated on time apportionment basis (N1,520-N1,220)			(300)
			92,500
Less: Allowable expenses:			
Administrative expenses			
– (₦ 9,500 – ₦ 1,050)		8,450	
Other operating expenses		1,420	
Actual total claims expenses	21,000		
Add: Estimated total claims	30,500		
Total claims and outgoing claimable.	51,500	51,500	
Interest expense		4,800	
			(66,170)
Less: Transfer to general reserve			
(i) General reserve < minimum authorised capital (50% of gross profit)			
Or			
(ii) General reserve ≥ minimum authorised capital (25% of gross profit) ₦ 58,410 x 25%			(14,602.5)
Assessable profit			11,727.5
Capital allowance			(650)
Total profit			11,077.5

Tax payable shall be the higher of:

Tax payable at 20% of total profit (N11,077,500 x 20%)	N2,215,500
Tax paid on 0.25% of gross premium (₦ 78,000,000 x 0.25%)	N195,000
Therefore, tax payable is	**N 2,215,500**
Education tax @ 2% of assessable profit (N11,727,500 x 2%)	**N234,550**

(d) Zen Insurance Co. Plc Summary of tax liabilities For 2021 assessment year

	Life business ₦'000	Non-life business ₦'000	Reinsurance business ₦'000	Total ₦'000
CIT payable	0.00	11,766	2,215.5	13,981.50
Education tax	0.00	800.4	234.55	1,034.95
Total tax payable	**0.00**	**12,566.4**	**2,450.05**	**15,016.45**

Notes:

(i) Under life insurance, section 16 (9) (a) provides for the deduction from the investment income of a life insurance company, an amount which makes a general reserve and fund equal to the net liabilities on policies in force at the time of an actuarial valuation. The implication of this is that the amount deductible as general reserve and fund shall for no reason be more than the amount of net liabilities on policies, that is, restricted to the maximum of net liabilities in force yearly.

In the light of the above, ₦1,298,000 was deducted from the investment income of the life business of Zen Insurance Co. Plc, being the net liabilities on policies as at December 31, 2020.

(ii) Under non-life insurance business and re-insurance business (being a non-life business), section 16 (8) (a) provides for the deduction of a reserve for unexpired risks, calculated on a time apportionment basis of the risks accepted in the year. The implication of this provision is that a reserve for unexpired risk can only be claimed on actual risks accepted in a year, that in the light of the above, the reserve for unexpired risk deducted from the gross income of Zen Insurance was ₦2,280,000 that is, (₦5,280,000 less ₦3,000,000) for non-life business and ₦300,000 that is, (₦1,520,000 less ₦1,220,000) for reinsurance business, each amount being the actual reserve for unexpired risk for the year.

(iii) Also, under non-life insurance business and re-insurance business, section 16 (8) (b) provides for the deduction of outstanding claims and outgoings. Essentially, the Act provides that an amount equal to the total estimated amount of all outstanding claims and outgoing shall be deducted but provided that any amount not utilized towards settlement of claims and outgoings shall be added to the total profits of the following year.

The implication of this is that what is allowed as deductible for outstanding claims and outgoings in any year shall be the total of both the actual and estimated claims and outgoings and that any amount unutilised (being either the total or a part of the estimated claims and outgoings) should be added back to the profits of the following year. This trend is expected to continue on a yearly basis.

Therefore, based on the above provision, the total amount of claims and outgoings applied under non-life insurance was ₦59,000,000, that is, ₦24,000,000 + ₦35,000,000; while the amount unutilised that will be added back to the profit of 2022 YOA is ₦35,000,000 (being the total unutilised estimated claims and outgoings in 2021).

Also, the total amount of claims and outgoings applied under re-insurance business was ₦51,500,000, that is, ₦21,000,000 + ₦30,500,000; therefore, the amount unutilised that will be added back to the profit of 2022 YOA is ₦30,500,000 (being the unutilised total estimated claims and outgoings under re-insurance business in 2021).

(iv) The applicable companies income tax rates used are in line with the provision of section 40 of CIT Act 2004(as amended).

Essentially, 0% was the companies income tax rate applied on the total profit of life business, whilst 30% and 20% rates of tax were applied to the total profits of non-life business and reinsurance business, respectively, taking into consideration their gross incomes.

9.4 Taxation of banks

(a) **Interests on loans earned by banks**

Banks are liable to tax under the provisions of Companies Income Tax Act (CITA) (as amended) and taxation of banks are computed like any other company liable to tax under CITA. However, the following interests earned by the banks shall be exempted from tax:

(i) Interest on loan granted for primary agricultural production shall be exempted from tax provided the moratorium is not less than 12 months and the rate of interest on the loan is not more than the base lending rate at the time the loan was granted, refinanced or otherwise restructured;
(ii) Interest on loan for fabrication of any local plant and machinery provided the moratorium is not less than 12 months and the rate of interest on the loan is not more than the base lending rate at the time the loan was granted, refinanced or otherwise restructured;
(iii) Any interest on loan to a company engaged in providing working capital for any cottage industry provided the moratorium is not less than 12 months and the rate of interest on the loan is not more than the base lending rate at the time the loan was granted, refinanced or otherwise; and
(iv) Interest on loan granted for the purpose of manufacturing goods for export provided that a certificate is issued by the Nigerian Exports Promotions Council stating that the level of export specified has been achieved by the company. In addition, the Nigerian Exports Promotions Council must certify that the goods exported are not less than 50% of the goods produced and that they were not re-exported to Nigeria.

(b) **<u>Other exempt income of banks These include:</u>**

(i) Government bonds: interest received by banks on federal and state government development loan stocks or bonds are exempted from tax.
(ii) Interest received on corporate bonds
(iii) Treasury bill discount income
(iv) Foreign placement: Interests earned by banks on foreign placements and brought into Nigeria in convertible currency are exempted from tax.
(v) Dividend income: dividend income treated as franked investment income.
(vi) Disposal of securities: gain from disposal of investment in stocks/securities.

(c) **<u>Disallowable bank expenses or provisioning</u>**

These include:

(i) Increase in provision on performing loans;

(ii) Increase in provisions on other assets or account receivable;
(iii) Increase in provisions on advance under finance lease;
(iv) Increase in provisions for diminution in the value of investments;
(v) Increase in provisions for off balance sheet engagement;
(vi) Increase in provisions for gratuity; and
(vii) Unrealised exchange loss.

9.5 Taxation of Unit Trust Scheme

Under the provision of the Companies Income Tax Act as amended to date, a unit trust scheme is established for the purpose of providing facilities for the participation of the public as beneficiaries under a trust, in profits or income arising from acquisition, holding, management or disposal of securities or any other property whatsoever. In respect of income arising to the trustees of an authorised unit trust, the following shall have effect:

a) As if the trustee were company whose business consist mainly in the making of investment and principal part of which income is derived thereof;
b) As if the right of the unit holders were shares in the company; and
c) As if so much of the income accruing to the trustee as is available for payment to the unit holders were dividends on such shares.
d) The adjusted profit of a unit trust scheme is obtained by deducting management expenses and the unit trust manager's remuneration from investment income.

Format

		N		N
Investment income		x		
Other taxable income	x	XX		
Deduct:				
Trust manager's remuneration	x			
Management expenses	x			
Other allowable expenses		x		(xx)
Adjusted profit			xxx	
Capital allowance		x		
Relieved		(x)	(x)	
Unrelieved capital allowances c/f	X			
Total profit				(XX)

9.6 Real estate investment companies that are approved by SEC under REIS

(a) **Definition**

"**Real estate investment company (REIC)"** means a company duly approved by the Securities and Exchange Commission to operate as a real estate investment scheme (REIS) in Nigeria.

(b) **Statutory provisions**

The regulations of real estate investment companies (REIS) in the Nigeria capital market include the provisions of the Investment and Securities Act 2007, the Securities and Exchange Commission Rules 2017, and other extant laws and regulations.

(c) **Nature of business**

REIS are investment vehicles which pool funds from investors comprising individuals, companies, pension funds, associations, etc. for investments in real estate as an asset class.

REIS are usually established to acquire, develop and hold portfolios of real estate assets, and do not generally hold single assets. They primarily engage in and invest in income generating real estate asset or real estate related asset.

Some REIS are structured to invest in specific property types whilst others focus their investments based on geographic location.

(d) **Income of REIC**

There are four broad classifications for the income of REIC, namely:

(i) Rental income;
(ii) Dividend from another REIC;
(iii) Gains from disposal of assets; and
(iv) Others, for example, fees and other income not related to REIS.

(e) **Taxation of the income of REIC**

(i) Dividend and rental income of REIC earned under a REIS

- **Section 19 of CITA (as amended)**

  This section relates to dividend as a basis for computing companies income tax due to no total profits or total profits are less than the amount of dividend paid. Rental and dividend income made by a REIC distributed to its shareholders under a REIS are exempt from section 19 of CITA. Put differently, the rental and dividend income redistributed to its shareholders shall be deducted from the total dividend paid in order to arrive at the net amount of dividend to be considered for the purposes of section 19 of this Act.

  It is apposite to state that for a dividend paid out by a REIC to be considered a redistribution under a REIS, the redistribution to shareholders must not be less than 75% of the rental or dividend income, and such redistribution must be done not later than 12 months after the end of the financial year in which the rental or dividend income was received by the REIC.

- **Section 23 (1) (s) of CITA (as amended)**

  Dividend and rental income received by a REIC under REIS are exempted from further tax in the hand of the company. Simply put, the gross amount of each of these incomes is treated as non-taxable income because the income is regarded as received on behalf of its shareholders.

In computing the assessable profits of a company, rental and dividend income will be deducted from the profits, if already included in same.

To qualify for this exemption, the REIC must ensure that:

- A minimum of 75% of dividend and rental income received is redistributed as dividend to the shareholders; and
- Such distribution is made not later than 12 months after the end of the financial year in which the dividend or rental income was earned.

Any rental or dividend income not distributed is chargeable to tax.

- **Section 24(1)(k) of CITA (as amended)**
  Dividends or mandatory distributions made by a REIC to its shareholders under REIS are allowable deduction for tax purposes.

  Given the fact that dividend or mandatory distribution made by a REIC to its shareholders is an expense relating to an exempt income, it shall not be allowed as a deduction in computing the company's assessable profits.

  It is pertinent to state that rental or dividend income received by a REIC will be treated as a taxable income, if the conditions stated in section 23(1)(s) of the Act is not met.

- **Section 80 of CITA (as amended)**
  Under section 80 of CITA, any distribution or dividend paid to a REIC pursuant to REIS shall not be subject to deduction of withholding tax. Based on the foregoing, such payment shall not be regarded as franked investment income unless when such payment is made to a REIC is not under a REIS.

- **Section 80(5)(6) of CITA (as amended)**
  A REIC is expected to withhold tax at the rate of 10% and remit same to the relevant tax authorities when a distribution or dividend is paid except such shareholder is a REIC under a REIS.

(ii) Gains from disposal of assets, fees, and other income not related to REIS
These incomes are not tax exempt as they are taxable in accordance with the provisions of the relevant tax laws.

9.7 Primary agricultural production

(a) Definition

Section 11(4) of CITA (as amended) defines "primary agricultural production" as:

(i) "Primary crop production comprising the production of raw crops of all kinds, but excluding any intermediate or final processing of crops or any other associated manufactured or derivative crop product;

(ii) Primary livestock production comprising the production of live animals and their direct produce such as live or raw meat, live or raw poultry, fresh eggs and milk of all kinds, but excluding any other associated manufactured or derivative livestock product;

(iii) Primary forestry production comprising the production of timber of various kinds such as firewood, charcoal, uncultivated materials gathered and other forestry products of all kinds, including seeds and saplings, but excluding the intermediate and final processing of timber and any other manufactured or derivative timber product; and

(iv) Primary fishing production comprising the production of fish of all kinds, including ornamental fish, but excluding any intermediate and final processing of any other manufactured or derivative fish product.

(b) Tax incentives

Small and medium-sized companies engaged in primary agricultural production shall be granted:

(i) Pioneer status for an initial period of 4 years and an additional period of 2 years, subject to satisfactory performance; and

(ii) A reduction in import duty on tractors from 35% to 5%.

To enjoy these tax incentives, these companies are expected to apply to the President through the Minister for Trade, Industry and Investment.

9.8 Tax implications of the operation of the regulated securities lending transactions ('SEC Lending') in Nigeria

(a) Definitions and nature of transaction

(i) **Definition of regulated security lending transaction**

Section 105 of CITA, having been amended by the Finance Act, 2019, "regulated securities lending transaction" means any securities lending transaction conducted in accordance with rules made by Securities and Exchange Commission.

(ii) Other definitions

- "Lender" means an authorised lender in a regulated securities lending transaction.
- "Borrower" means an authorised borrower in a regulated securities lending transaction.

- "Lending agent" means any person authorised by the Securities and Exchange Commission to function as a go-between for the performance of a regulated securities lending transaction.
- "Compensating payments" means any payments made in lieu of interest or dividend in accordance with a regulated securities lending transaction.
- "Dividend" means compensating payments received by a lender from its authorised agent or borrower in a regulated securities lending transaction if the fundamental transaction giving rise to the compensating payment is a receipt of dividends by a borrower or any shares or securities received from its approved agent or a lender in a regulated securities lending transaction.

(b) **Relevant regulatory provisions**

The provisions of the Investment and Securities Act, Securities and Exchange Commission Rules 2013 (as amended) and other extant laws and regulations control the operation of SEC lending in the Nigerian capital market.

The taxation of SEC lending transactions is influenced by CITA and other relevant tax laws.

(c) **Income**

Income under a SEC lending covers the following:

(i) Dividends;
(ii) Interests;
(iii) Securities lending fees or any other right or reward arising from the securities loaned;
(iv) Rights;
(v) Bonus; and
(vi) Redemption benefits.

(d) Taxation of a SEC lending based on the provisions of CITA (as amended)

(i) Dividend and interest received

The relevant provisions of the Act as they apply to dividend and interest received are as follows:

- **Section 9 of CITA (as amended)**
  Under section 9(1) (c) of the Act, gross dividend and interest received by a lender and borrower, being income, are taxable.

- **Section 23 of CITA (as amended)**
  Despite the provision of section 9 (1) (c) of CITA which regards gross dividend and interest received by a lender and borrower as taxable, section 23(1)(t) and (u) of the Act, provides that dividend received by a lender from a borrower or by an agent from a borrower under SEC Lending is a franked investment income, hence it is not subject to further tax in the hand of the lender.

  Given the provisions of section 23(1) of the Act, interest received by an agent from a lender under SEC lending is tax exempt in the hand of the agent.

- **Section 24 of CITA (as amended)**
  Interest paid by a lender to an agent or a borrower under a SEC Lending is an allowable deduction under section 24(1)(l) of the Act.

- **Section 27 of CITA (as amended)**
  Dividend generated by a borrower, and paid to an agent or lender under SEC Lending will not be an allowable deduction to the borrower in accordance with section 27(1) (l) of the Act.

- **Section 78 of CITA (as amended)**
  The interest received by a borrower from a lender is liable to withholding tax deduction as provided under section 78 of the Act.

  Where the borrower receives beneficial interest from the lender through the agent, the responsibility to deduct withholding tax rests with the agent.

  Where the agent remits interest to the borrower, the agent is to deduct withholding tax.

- **Section 80 of CITA (as amended)**
  Under this section of the Act, payment of a dividend from a borrower to an agent shall not be subject to deduction of withholding tax.

(ii) **Fees, rights, bonuses and other benefits**
Under section 9(1)(h) of CITA, rights, bonuses, profits, fees and other benefits received by a borrower or lender under a SEC Lending are taxable income.

(e) Income received by an individual under a SEC Lending

Given the fact that the above stated exemptions and concessions provided in CITA relate to persons taxable under CITA, dividend and interest received under SEC Lending by individuals are not tax exempt.

(f) Relevance of Stamp Duties Act to SEC Lending

The following documents and transactions are exempt from stamp duties:

(i) All documents issued by the SEC in relation to a SEC Lending;
(ii) Shares, stocks or securities returned to a lender or its recognised agent by a borrower in accordance with the rules of SEC Lending;
(iii) Receipts given by any person under a SEC Lending; and
(iv) Shares, stocks or securities transferred by a lender to its agent or borrower in furtherance of a SEC Lending.

9.9 Exemption of the profits of a NIgerian company from tax in respect of goods exported from Nigeria

In line with the provision of section 23(q) of CITA, the profits of any Nigerian company in respect of goods exported from Nigeria is exempted from tax provided that the proceeds from such exported goods are repatriated to Nigeria and are used exclusively for the purchase of raw materials, plant, equipment and spare parts.

The Finance Act, 2019 amended the criteria for tax exemption of profit in respect of goods exported from Nigeria by inserting a paragraph stating that tax shall accrue proportionately on the portion of proceeds from exported goods that are not utilised exclusively for the purchase of raw materials, plant, equipment and spare parts.

9.10 Provision of the Nigeria Police Trust Fund (Establishment) Act, 2019, as it relates to the levy of 0.005% of the net profit of companies operating in Nigeria

Nigeria Police trust fund levy was introduced to the Nigerian tax system in 2019 by virtue of the provisions of the Nigeria Police Trust Fund (Establishment) Act, 2019 that was enacted in 2019.

The objective of the Act is "to provide a legal framework for management and control of the special intervention fund established under section 3 of the Act for the training and retraining of personnel of the Nigeria Police Force and for the provision of state of the art security equipment and other related facilities for the enhancement of the skills of the personnel of the Nigeria Police in the handling of operational equipment and machineries".

The Trust Fund is to operate for six years from the commencement of the Act and is expected to cease at the expiration the period unless it is extended by an Act of the National Assembly for any further period.

The Act established a fund known as the Nigeria Police Trust Fund which is a body corporate with perpetual succession and a common seal, and may sue and be sued in its corporate name.

The Trust Fund shall consist of:

(a) An amount consisting of 0.5% of the total revenue accruing to the Federation Account;
(b) A levy of 0.005% of the net profit of companies operating in Nigeria;
(c) Any take-off grant and special intervention fund as may be provided by the Federal, State and Local Government of the Federation;
(d) Such money as may be appropriated to meet the objective of the Act by the National Assembly in the budget;

(e) Aids, grants and assistance from international, bilateral and multilateral agencies, non-governmental organisations and the private sector;

(f) Grants, donations, endowments, bequests and gifts, whether of money, land or any other property from any source; and

(g) Money derived from investment made by the Trust Fund.

The Trust Fund shall be utilised as follows:

(a) For meeting the training and re-training needs of the personnel of the Nigeria Police Force and its auxiliary staff within and outside Nigeria;

(b) For the enhancement of the skills of the personnel of the Nigeria Police Force and its auxiliary staff for improved proficiency in the use of operational equipment and machineries;

(c) For the overall improvement, performance and efficiency in the discharge of the duties and responsibilities of the Nigeria Police Force;

(d) For the purchase of equipment, machineries, including operational vehicles for the Nigeria Police Force;

(e) For the construction of police stations, provision of living facilities, such as quarters or barracks for the Nigeria Police Force;

(f) To finance the procurement of books, instructional materials, training equipment for use at Police Colleges and such other similar training institutions;

(g) To meet the cost of participation by the personnel of the Nigeria Police Force at seminars and conferences relevant to, or connected with, policing or intelligence gathering; and

(h) For such other purposes incidental to, or connected with, the attainment of objective of the Act.

9.11 Chapter review

This chapter discusses tax procedures to be adopted for some companies classified as special because of certain peculiarities. It also covers those salient points to take note in the computations of tax as appropriate for insurance, shipping, air transport, courier, wireless telecommunications companies, banks and unit trust scheme

The chapter also discusses the implications of Finance Acts, 2019 and 2020 on taxation of insurance business, real estate investment companies, and securities lending transactions in Nigeria.

9.12 Worked examples

9.12.1 Open-ended Questions

1. Habib Limited is a foreign company involved in air transport business. Its aircrafts are used for cargo and passenger flights between Nigeria and Spain. The audited financial statements for year ended December 31, 2020, revealed the following:

	₦	₦
Income for passengers flown from Madrid to Nigeria		4,425,600
Income for passengers flown from Nigeria to Madrid		3,397,250
Income from cargo loaded into aircraft other routes		2,260,000
Income from cargo freight from Nigeria to Madrid		3,375,000
`		13,457,850
Deduct: Operating expenses:		
Depreciation	460,000	

Staff salaries	725,000	
Use of airport facilities	87,000	
Accommodation for airtime crew	28,500	
Hotel bills for passengers	120,000	
General provisions	35,000	(1,455,500)
Operating profits		12,002,350

In addition to the above, capital allowances were agreed with the relevant tax authority as 175% of depreciation.

Required:

1. Compute the income tax liability for assessment year 202(Ignore minimum tax computation)

2. Explain the unique procedure for assessing non-Nigerian companies in Air and Sea transportation business to tax in Nigeria.

3. According to Section 14 of CITA (as amended), specific provision has been put in place for the taxation of some non-Nigerian companies.

Required:

4. Discuss these provisions.

5. Explain the differences in procedures for the assessment of Nigerian and non-Nigerian life assurance companies.

9.12.2 Suggested solutions to open-ended questions

(1) **Habib Limited**

Income tax computation for 2021 assessment year

Global income

₦13,457,850

Nigerian income (3,397,250 +3,375,00) ₦6,772,250

Global adjusted profit computation

	₦	₦
Net profit per account		12,002,350
Add: depreciation	460,000	
General provision	35,000	495,000
Global adjusted profit		12,497,350

Computation of global adjusted profit (GAP) ratio;

GAP x 100

GLOBAL INCOME 1

$$\frac{₦12,497,350}{₦13,457,850} \times \frac{100}{1} = 92.86\%$$

viii) Computation of Nigerian adjusted profit:

Gap Ratio x Nigerian income

= 92.86% x ₦6,772,250

= ₦6,288,711

ix) Capital allowance(175% of N460,000) = N805,000

x) Computation of total profit: ₦

xi)	Nigerian adjusted profit	6,288,711
	Less: capital allowance	805,000
	Total profit	5,483,711
	Tax payable as at 30%	₦1,645,113

2. The procedures are:

i) Determine the global income by aggregating all the incomes of the particular company in the relevant year of assessment;

ii) Determine the Nigerian income i.e. income on goods, mails, passengers, etc shipped or carried out of Nigeria;

iii) Compute the global adjusted profit (GAP) by applying the principle of trading profit adjustment treating allowable and disallowable items of income and expenses;

iv) Compute the global adjusted profit ratio using this formula;

$$\frac{\text{Global adjusted profit}}{\text{Global income}} \times \frac{100}{1}$$

v) Compute the depreciation ratio using this formula:

$$\frac{\text{Depreciation expenses charged in the accounts}}{\text{Global income}} \times \frac{100}{1}$$

vi) Compute Nigerian adjusted profit thus:

Gap ratio x Nigeria income

vii) Compute capital allowance relief thus:

Depreciation ratio x Nigerian income

viii) Determine the total profit;

	₦
Nigerian adjusted profit	xx
Less capital allowance relief	(xx)
Total profit	xx

ix) Determine tax payable by applying the applicable tax rate on the total profit in "h" above

3. Section 14 of CITA (as amended), contains provisions regarding companies, other than Nigerian companies, in shipping or air transport business.

The substance of that section is as follows:

(a) The profits or losses of such company to be deemed to be derived from Nigeria is the full profits or losses arising from the carriage of passengers, mails, livestock or goods shipped, or loaded into an aircraft, in Nigeria. This does not apply to passengers, mails, livestock or goods which are brought into Nigeria solely for transshipment or for transfer from one aircraft to another or in either direction between an aircraft and a ship. To the sums receivable in respect of passengers, etc. carried in Nigeria asreferred to above, there shall be applied the following:

(i) The ratio of profits or losses of an accounting period, before depreciation, to the total sums receivable in respect of the business of the company; and

(ii) The ratio of depreciation to the total sums receivable as certified by the tax authority of any other country (where the Non-Nigerian company is registered) to the satisfaction of the Revenue Service. This ratio shall beapplied on the on the Nigerian income to arrive at the capital allowance for the relevant tax year.

The amount arrived at shall be the full profits or losses which shall be liable to Nigerian tax.

Note that this situation will apply where the Revenue is satisfied that the tax authority of any other country computes and assesses on a basis not materially different from that prescribed by the CITA of Nigeria.

(a) Where the ratios referred to above 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 passenger, etc. shipped or loaded in Nigeria. When this occurs, the company has within six years to claim that its liability be recomputed on the basis of the ratios referred to above; and

(b) If the company fails to agree with the Revenue Service, the Revenue Service shall give notice to the company of refusal to admit the claim and the provisions of CITA with respect to objections and appeals shall apply accordingly with any necessary modifications.

However, where there is agreement on the two ratios and the Nigerian Tax Authority is convinced that Nigerian companies enjoy similar treatment in the country of the foreign company, the understated procedure shall be adopted to subject the company to tax.

4. The differences are in the process of determining the assessable profit of such company for Nigerian tax purpose. This is represented as stated below:

The assessable profit and tax liability of a Nigerian company carrying on life assurance business is determined as follows:

Nigerian company: The assessable profit and tax liability of a Nigerian company carrying on life insurance business is determined as follows:

	₦	₦	₦
Investment income			xx
Other income			xx
Actuarial revaluation surplus distributed			xx
Gross income			xx
	₦	₦	₦
Deduct:			
• i. General reserves	Xx		
Add life fund a/c	Xx	xx	
less net liabilities on policies	(x)	x	
iv. Special reserve			
The higher of:			
1 % of gross premium OR	x		
10% of net profit	x	x	
v. Other allowable management (x) expenses		x	

Assessable profit	**xx**
Less capital allowance	(x)
Total profit	x

Tax payable shall be the higher of:
Tax paid as per total profit computed; and
Tax paid on 0.5% of gross income

Notes:
Annual transfer to special reserves would depend on whether the total reserves are equal to or higher than the minimum statutory paid up capital.

Also, the above minimum tax of 0.5% on gross income has been reduced to 0.25% on gross income for tax returns prepared and filed for any year of assessment falling due on any date between January 1, 2020 and December 31, 2021, both days inclusive.

(i) **Non-Nigerian company:** The assessable profit of a non- Nigerian company carrying on life assurance business is determined as follows:

	₦	₦
Investment income (see working1)	x	
Less Agency commission in Nigeria	x	
Allowable expenses in Nigeria	x	
Fair proportion of head office expenses	x	(x)
Assessable profit		x

Working

Investment income:

$$\frac{\text{Premium receivable in Nigeria}}{\text{Global premium receivable of the company}} \times \frac{\text{Global investment income}}{1}$$

Professional level

Advanced Taxation

10

Taxation of investment income (Nigerian and non-Nigerian Companies)

Contents

Taxation of investment income (Nigerian and non-Nigerian companies)

10.0 Purpose

After studying this chapter, readers should be able to:

(a) Discuss the basis of assessment of investment income; and
(b) Compute the tax liability of persons earning investment income.

10.1 **Introduction**

Investment incomes are incomes received primarily from investment decisions. Investment decisions include decisions such as purchase of shares, purchase of property for letting purposes, placement of cash in fixed and other interest yielding accounts etc. The incomes that accrue as a result of the investment decisions are called investment incomes and they include dividend, interest, royalty, rent, etc.

10.2 **Basis of assessment of investment income**

The basis of assessment of dividend, interest, rent and royalty is the preceding year basis. The assessable income from each year of assessment is the income of the year immediately preceding the year of assessment.

10.3 **Dividend Income**

Dividend is the profits distributed by a company to its shareholders in proportion of their respective shareholdings. However, the Personal Income Tax Act Cap C21 LFN 2004 (as amended) defines dividend as:

(a) In relation to company not being in the process of being wound up or liquidated, any profits distributed whether such profits are of a capital nature or not, including an amount equal to the nominal value of bonus share, debentures or securities awarded to the shareholders; and

(b) In relation to a company that is being wound up or liquidated, any profits distributed, whether in money or money's worth or otherwise, other than those of a capital nature earned before or during the winding up or liquidation.

Nigerian dividend

The income from a dividend distributed by a Nigerian company, shall be deemed to be derived from Nigeria, and shall be the gross amount of that dividend before the deduction of any tax which the company is required to deduct on payment thereof under the provisions of any law in force in Nigeria at the relevant time imposing taxation on the profits of companies.

Nigerian dividends received by companies other than Nigerian companies

When dividends is received by a company that is neither a Nigerian company nor engaged in a trade or business in Nigeria at any time during the year of assessment;

(c) No tax shall be charged on it for that year in respect of the dividend received by it from Nigerian company apart from withholding tax.

(d) Where any dividend is paid out of profit for which no tax is payable due to no total profit or total profit which are less than the amount of dividend which is paid, whether the recipient of the dividend is a Nigerian company or not, the company paying the dividend shall be charged to tax at the prevailing companies income tax rate as if the dividend is the total profits of the company for the year of assessment.

Undistributed profit of a Nigerian company deemed to be dividend

Any amount of undistributed profit of a Nigerian company which is treated as distributed under the provisions of any law in force in Nigeria imposing tax on the profits of companies shall be deemed to be income from a dividend accruing to any person who is a shareholder in the company in proportion to his share in the ordinary capital thereof at the relevant time, and the income for the dividend be taken for assessment in his hands shall be his due proportion thereof increased by such amount as may be specified by the relevant tax authority in respect of tax deemed to be deducted at source.
The income from a dividend distributed by a Nigerian company shall be deemed to arise on the day on which payment of that dividend becomes due.

Dividend exempted from tax

The following dividend incomes are exempted from tax:

(a) Dividend earned from abroad and brought into Nigeria by a Nigerian resident in convertible currency and paid into a domiciliary account in a bank approved by the government;

(b) Dividend paid to a person by a company incorporated in Nigeria if the equity participation of the person in the company paying the dividend is either wholly paid for in foreign currency or by assets brought into Nigeria between 1 January 1987 and 31 December 1992 and the person to whom the dividend are paid own not less than 10 per cent of the equity shares of the company. The dividend tax free period is 5 years if the company paying the dividend is engaged in agricultural production within Nigeria or processing of Nigeria agricultural products produced within Nigeria or production of petrochemicals or liquefied natural gas, and in any other case, the tax free period is 3 years. The tax free period commences from the year of assessment following the year in which the new capital is brought into Nigeria for the real purpose of the trade or business in Nigeria of the company paying the dividend.

Relevant territory in which dividend paid by a Nigerian company arises
Where a dividend is distributed or paid by a Nigerian company, the dividend, whenever necessary, shall be deemed to be derived from the territory in which the recipient of the dividend resides or, where the recipient is not resident in Nigeria, the person shall be deemed to be a person resident outside Nigeria and who derives income or profit in Nigeria. Dividend derived by a non-resident person shall be deemed derived from the Federal Capital Territory.

10.4 Interest Income

The income from any interest on money lent by an individual, or executor, or a trustee, outside Nigeria to a person in Nigeria (including a person who is resident or present in Nigeria at the time of the loan) shall be deemed to be derived from Nigeria if:

(a) There is a liability to payment in Nigeria of the interest regardless of what form the payment takes and wherever the payment is made;
(b) The interest accrues in Nigeria to foreign company or person regardless of what form the payment takes and wherever the payment is made.

Interest from a source outside Nigeria

Where an individual is resident in Nigeria, the interest accruing to him from a source outside Nigeria is liable to tax in Nigeria if such amount of interest is brought into or received in Nigeria subject to double taxation provisions, if applicable.

Relevant territory in which interest paid by a Nigerian company arises

Where interest is paid by a Nigerian company, the interest, whenever necessary, shall be deemed to be derived from the territory in which the recipient of the interest resides or, where the recipient is not resident in Nigeria, the person shall be deemed to be a person resident outside Nigeria and who derives income or profit in Nigeria. Interest derived by a non resident person shall be deemed derived from the Federal Capital Territory.

Interest exempted from tax

The following interest incomes are exempted from tax:

(a) Interest accruing to a person on foreign currency domiciliary account;

(b) With effect from 1 January 1996, 100% of certain foreign incomes are exempted from tax provided that such incomes are repatriated into Nigeria in convertible currency and paid into a domiciliary account in a bank approved by government. Income falling into this category includes interest earned from abroad and brought into Nigeria by a Nigeria resident;

(c) Interest accruing to a person who is not resident in Nigeria as specified below:

- (i) The interest on a loan charged on the public revenue of the Federation and raised in the United Kingdo
- (ii) The interest on a bond issued by the Government of the Federation to secure repayment of loan raised from the International Bank for Reconstruction and Development under the authority of the Railway Loan (International Bank) Act;
- (iii) The interest on any money borrowed by the Government of the Federation or of a State on terms which include the exemption of interest from tax in the hands of a non- resident person;
- (iv) Where the Minister of Finance so consents, the interest on any moneys borrowed outside Nigeria by a corporation established by a law in Nigeria upon terms which include the exemption of such interest from tax in the hands of any non-resident person; and;
- (v) The interest on deposit accounts, provided the deposit into the account are transfers wholly made up of foreign currencies (funds) to Nigeria on or after 1st January 1990 through Government approved channels and the depositor does not become non-resident after making the transfer while in Nigeria.

(d) Interest on any loan granted by a bank on or after 1 January 1997 to a person engaged in:

- (i) Agricultural trade or business;
- (ii) The fabrication of any local plant and machinery; and

(iii) As working capital for any cottage industry established by the person under the Family Economic Advancement Programme, if the moratorium is not less than 18 months and the rate of interest on the loan is not more than the base lending rate at the time the loan was granted

10.5 Royalty

Royalty is a payment to an owner for the use of property, especially patents, copyrighted works, franchises or natural resources. A royalty payment is made to the legal owner of a property, patent, copyrighted work or franchise by those who wish to make use of it for the purposes of generating revenue or other such desirable activities. In most cases, royalties are designed to compensate the owner for the asset's use, and are legally binding.

Income chargeable

Royalties are often expressed as a percentage of the revenues obtained using the owner's property, but can be negotiated to meet the specific needs of an arrangement. The use of royalties is common in situations where an inventor or original owner chooses to sell their product to a third party in exchange for royalties from the future revenues it may generate.

Royalty exempted from tax

Royalty earned from abroad and brought into Nigeria shall be exempt from tax, provided that such income is brought in convertible currency and paid into a domiciliary account in a bank approved by the Federal Government.

10.6 Rental Income

The gain or profit arising from other person for the use or occupation of any property is chargeable to tax. Thus rental income is generally deemed to accrue to the recipient daily (i.e. from day to day) over those periods covered by the payment.

Rent received in advance

If rent is received in advance, it will be spread over the period of the rent (provided the period is not more than 5 years). However, if rent received in advance covering a period that is more than 5 years, it will be spread for 5 years. Thus for tax purposes, the gains or profit arising from rent of a property is ascertained by deducting only those expenses that were directly incurred for the purpose of earning the income.

Allowable rental expenses

In computing the gain or profit from rental income for tax purposes, the following expenses are allowable deductions:

(a) Tenement rates or land use charge;
(b) Cost of collecting rent e.g. fees paid to a caretaker, estate agent, legal representative, etc.;
(c) Cost of advertising for tenants;
(d) Any expenses incurred for repairs and maintenance of the building;
(e) Bad debt incurred;
(f) Interest on money borrowed and employed in acquiring or renovating the property;
(g) Commission paid to agent or caretaker;
(h) Insurance premium paid on the property; and
(i) Water rate.

Disallowable rental expenses

(a) Any expenses not incurred for the purpose of earning the rental income;
(b) Any expenditure of capital nature;
(c) Depreciation of the building; and
(d) Appropriation of profit including income tax, drawings, reserves, etc.

10.7 Real estate investment companies (REICOs) income – Finance Act, 2019

With Finance Act, 2019, the following sections of CITA have been amended to remove existing bottlenecks hindering the operations of real estate investment companies (REICOs):

- Sec. 19 (excess dividend tax) no longer applicable to distributions by REICOs to its shareholders.
- Section 23 - Exemption of dividend and rental income received by a REICO on behalf of its shareholders, if a minimum of 75% is distributed within 12 months.
- Section 24 – Distributions to REICO shareholders to be treated as allowable deductions.

In view of the foregoing amendments, REICO shall be liable to Income Tax:
On management fees and other income earned when less than 75% of Income is distributed to Shareholders and when dividend distribution is not made within 12 months.
Dividend to shareholders is liable to 10% WHT Deduction by REICO.

10.8 Franked investment income

Dividend received by a company after deduction of withholding tax at source by a paying company is regarded as franked investment income of the company receiving the dividend. Such income is not subject to further tax in the hands of the recipient company as the withholding tax deducted at source is the final tax.

The dividend will be excluded from the total profits of a company receiving the dividend before the computation of the company's income tax liability.

Where dividend received (i.e. franked investment income) is distributed by the recipient company, it has a right to set off the withholding tax paid on the dividend received from the withholding tax payable on the redistributed dividend. This provision helps to prevent double taxation.

10.9 Chapter review

This chapter provides a detailed explanation of the various investment incomes including, dividend, interest, royalty and rent. It also highlights the basis of assessment of investment as well as investment incomes that are tax exempt. The readers must have learnt the implications of Finance Act, 2019 to taxation of real estate investment companies.

10.10 Worked examples

10.10.1 Open-ended questions

(1) Mr. Chukwuemeka Okoye completed the construction of his building, a two wing duplex located in Gwagwalada, Abuja, on December 31, 2016. He rented out both flats with effect from January 1, 2017, through an estate agent and received rent for two years. He made available the following details of his income and expenses for the relevant period:

	2017	2018
	₦	₦
Rent received (Gross)	3,500,000	3,500,000
Expenses:		
Repairs and maintenance	220,000	450,000
Water rate	82,000	105,000
Agent's commission	350,000	350,000
Professional charges	100,000	150,000
Insurance	52,000	52,000
Caretaker's wages	18,000	22,000
Tenement rate	25,000	32,000

Additional information:

(i) Capital allowances agreed with the relevant tax authority for 2018 and 2019 were ₦480,000 and ₦120,000, respectively.

(ii) Repairs and maintenance comprised:

Depreciation	₦100,000	₦85,000
Repairs of tenant's bathroom	0	₦180,000
Repairs of Mr. Chukwuemeka's residence	₦120,000	₦185,000

(iii) Tenement rate includes tenement rate of ₦5,000 and ₦20,000 paid on the private residence of Mr. Chukwuemeka for 2017 and 2018.

Required:
Compute the amount of rental income assessable to tax for the relevant tax years.

(2) Nelson & Sons Limited is a company owned by the members of Nelson family. Its issued share capital of 20,000,000 ordinary shares of N1 each are held by:

Williams Nelson	8,000,000 shares
Samuel Nelson	4,000,000 shares
Tamara Nelson	2,000,000 shares
Malia Nelson	6,000,000 shares

- For the year ended December 31, 2012, the company made a net profit before tax of N53,000,000. The company has not paid dividend since it was established 8 years ago.

- The Federal Inland Revenue Service is of the opinion that the non-payment of dividend by the company was with a view to reducing the tax payable by its shareholders. In exercise of the powers conferred on it by the Companies Income Tax Act, the FIRS has directed that N15,900,000 of the profit be treated as having been distributed as dividend.

Required:
Compute the amount deemed to be income in the hands of the company's shareholders.

(3) **E**xplain briefly the following:

(a) Dividend income
(b) Interest income
(c) Rental income
(d) Royalty income
(e) Nigerian Dividend

(4) (a) Explain briefly the provisions of the tax law in respect of rental income received in advance.
(b) In computing the gains or profit from rental income, certain expenses are allowed as deductible.

Required:
Explain **FIVE** examples of expenses that can be deducted when computing rental income.

10.10.2 Suggested solutions to open-ended questions

(1) Mr. Chukwuemeka Computation of rental income

For the relevant assessable years

	2018		2019	
	₦	₦	₦	₦
Rent received	3,500,000			3,500,000
Less: Allowable expenses:				
Repairs and maintenance:				
Repairs of tenant's bathroom -	180,000			
Water rate	82,000			105,000
Agent's commission	350,000			350,000

Professional charges		100,000		150,000
Insurance		52,000		52,000
Caretaker's wages		18,000		22,000
Tenement rate	20,000	(622,000)	12,000	(871,000)
Assessable rent		2,878,000	2,629,000	
Less: Capital allowances		(480,000)		(120,000)
Chargeable rent		2,398,000		2,509,000

(2) **Nelson & Sons Limited**

Computation of amount deemed as income in the hand of shareholders

	Deemed	**Dividend ₦**
Williams Nelson	$\frac{8,000,000}{20,000,000}$ X ₦15,900,000	6,360,000
Samuel Nelson	$\frac{4,000,000}{20,000,000}$ X ₦15,900,000	3,180,000
Tamara Nelson	$\frac{2,000,000}{20,000,000}$ X ₦15,900,000	1,590,000
Malia Nelson	$\frac{6,000,000}{20,000,000}$ X ₦15,900,000	4,770,000

(3) (a) **Dividend Income:** Dividend is the profits distributed by a company to its shareholders in proportion of their respective shareholdings. However, the Personal Income Tax Act CAP P8 LFN 2004, defines dividend as:

(i) In relation to a company not being in the process of being wound up or liquidated, any profits distributed whether such profits are of a capital nature or not, including an amount equal to the nominal value of bonus share, debentures or securities awarded to the shareholders; and

(ii) In relation to a company that is being wound up or liquidated, any profits distributed, whether in money or money's worth or otherwise, other than those of a capital nature earned before or during the winding up or liquidation.

(b) **Interest Income:** The income from any interest on money lent by an individual, or executor, or a trustee, outside Nigeria to a person in Nigeria (including a person who is resident or present in Nigeria at the time of the loan) shall be deemed to be derived from Nigeria if:

(i) There is a liability to payment in Nigeria of the interest regardless of what form the payment takes and wherever the payment is made

(ii) The interest accrues in Nigeria to foreign company or person regardless of what form the payment takes and wherever the payment is made

(c) **Rental Income:** The gain or profit arising from other person for the use or occupation of any property is chargeable to tax. Thus rental income is generally deemed to accrue to the recipient daily (i.e. from day to day) over those periods covered by the paym

(d) **Royalty income:** Royalty is a payment to an owner for the use of property, especially patents, copyrighted works, franchises or natural resources. A royalty payment is made to the legal owner of a property, patent, copyrighted work or franchise by those who wish to make use of it for the purposes of generating revenue or other such desirable activities. In most cases, royalties are designed to compensate the owner for the asset's use, and are legally binding.

(e) **Nigeria dividend:** The income from a dividend distributed by a Nigeria company, shall be deemed to be derived from Nigeria and shall be the gross amount of that dividend before the deduction of any tax which the company is required to deduct on payment thereof under the provisions of any law in force in Nigerian at the relevant time imposing taxation on the profits of companies.

4 (a) **Rent received in advance:** If rent is received in advance, it will be spread over the period of the rent (provided the period is not more than 5 years). However, if rent received in advance covering a period, that is more than 5 years, it will be spread for 5 years. Thus for tax purposes the gains or profit arising from rent of a property is ascertained by deducting only those expenses that were directly incurred for the purpose of earning the income.

(b) Allowable rental expenses

In computing the gain or profit from rental income for tax purposes, the following expenses are allowable deductions

(i) Tenement rates or land use charge;
(ii) Cost of collecting rent e.g. fees paid to a caretaker, estate agent, legal representative, etc.;
(iii) Cost of advertising for tenants;
(iv) Any expenses incurred for repairs and maintenance of the building;
(v) Bad debt incurred;
(vi) Interest on money borrowed and employed in acquiring or renovating the property;
(vii) Commission paid to agent or caretaker;
(viii) Insurance premium paid on the property; and
(ix) Water rate.

11

Pioneer legislation

Contents

17 Pioneer legislation

11.0 Purpose

After studying this chapter, readers should be able to:

(a) Understand the major provisions of The Industrial Development (Income Tax Relief) Act, 1971 and how they apply to tax computations of pioneer companies;

(b) Know the application guidelines for pioneer status incentive issued by Federal Ministry of Industry, Trade and Investment in 2017;

(c) Identify the pioneer conditions for pioneer status;

(d) Know the importance of production day to a pioneer company;

(e) Know the duration of the relief and procedure for getting additional years;

(f) Know the reports and documents to be filed during the pioneer period;

(g) Know the incentives for small and medium-sized companies engaged in primary agricultural production as contained in Finance Act, 2020

(h) Prepare income tax computations applying the provisions of CITA IDA; and

(i) Know the offences and penalties as specified by the Act.

11.1 Introduction

One of the investment incentives available to industries in Nigeria is contained in the Industrial Development (Income Tax Relief) Act 1971 (IDITRA) which came into force on April 1, 1970. In 2017, the application guidelines for pioneer status incentive (PSI) were issued by the Federal Ministry of Industry, Trade and Investment.

Pioneer tatus ncentive is a tax holiday which grants qualifying industries and products relief from the payment of companies income tax for an initial period of three years, extendable for one or two additional years.

The Nigerian Investment Promotion Commission (NIPC) issues a pioneer certificate. The certificate evidences the granting of a pioneer status and must contain the following particulars:

(a) . Name of the pioneer company;
(b) The production day; and
(c) The nature of the company's business.

Where an extension of pioneer status is required, not less than 30 days after the end of the initial pioneer period, the application for an extension must be filed with the NIPC together with the pioneer certificate, as the certificate must be replaced if the application is eventually granted.

11.2 Relevant definitions {section 25}

The terms defined in section 25 of IDA and their respective meanings are reproduced below:

Accounting period
A period for which accounts have been made up in accordance with the requirement of paragraph (c) of section 11 of IDA;

Revenue Service The Federal Inland Revenue Service established under CITA;

Company
A company (other than a private company) limited by shares and incorporated and registered in Nigeria and resident in Nigeria;

The Council
The National Council of Ministers (Federal Executive Council);

The Director
The director appointed pursuant to Section 1(3) of the Industrial Inspectorate Act;

Gazette
The Federal Gazette and includes the Gazette of any state in the Federation;

The Minister
The Minister for industry;

New trade or business
The trade or business of a pioneer company deemed to have been set up and commenced on the day following the end of its tax relief period;

Old trade or business
The trade or business of a pioneer company carried on by it during its tax relief period and which either ceases within that period or is deemed to cease at the end of that period;

Permissible by-product
Any goods or services so described in any pioneer certificate being goods or services necessarily or ordinarily produced in the course of producing a pioneer product;

Pioneer certificate
A certificate given under IDA certifying, among other things, a company to be a pioneer company;

Pioneer company
A company certified by any pioneer certificate to be a pioneer company;

Pioneer enterprise
In relation to a pioneer company, means the production and sale of its relevant pioneer product or products;

Pioneer industry
Any trade or business of the kind included in any list of pioneer industries published in the gazette;

Pioneer product
Goods or service of the kind included in any list of pioneer products published in the gazette;

Principal Act
The Companies Income Tax Act;

Production day
The day on which the trade or business of a pioneer company commences for the purpose of CITA;

Qualifying capital expenditure
Capital expenditure of such a nature as to rank as Qualifying expenditure for capital allowances purposes of the principal Act;

Product
The pioneer product or products and the permissible by-pioneer product or products specified in the pioneer certificate of any company;

Tax relief period
The period specified under subsection (1) of Section 10 of IDA and any extension of that period made under that Section.

11.3 Relevant arms of government involved in the formulation, approval and issuance of pioneer status incentive (PSI)

The following arms of government play key roles in the formulation, approval and administration of the PSI:

a. **Federal Executive Council**: On the authority of the President, the FEC is responsible for amending the list of pioneer industries and pioneer products ("Pioneer List") from time to time;

b**.** **Federal Ministry of Industry, Trade and Investment ("FMITI")**: The Minister of Industry, Trade and Investment, is responsible for specifying the mode of application for PSI;

c. **Nigerian Investment Promotion Commission ("NIPC")**:

i. On the delegated authority of the Minister of Industry, Trade and Investment, NIPC is responsible for processing PSI applications and cancelling pioneer certificates if the provisions of the IDA and the guideline document are contravened; and

ii. On the delegated authority of the President, NIPC is responsible for approving and extending PSI, and issuing pioneer certificates;

d. **Industrial Inspectorate Department of FMITI ("IID")**: The Industrial Inspectorate Department (IID) is responsible for certifying the date of production/date from which the PSI will take effect; and

e. **Federal Inland Revenue Service ("FIRS")**: The FIRS is responsible for implementing PSI and issuing certificates of qualifying capital expenditure.

11.4 Pioneer status incentives regulations by Nigerian Investment Promotion Council (NIPC) in 2014 and 2017

Where the National Council of Ministers (the Council) is satisfied that:

(a) Any industry is not being carried on in Nigeria on a scale suitable to the economic requirements of Nigeria, or there are favourable prospects of further development in Nigeria of any industry; or

(b) It is expedient in the public interest to encourage the development or establishment of any industry in Nigeria; it may declare the industry a pioneer industry, and products of the industry - pioneer products.

The conditions that must be met by an applicant are as stated hereunder:

i. An applicant must make a new application in the first year of production/service and must apply for an extension not later than one month after the expiration of the initial tax relief period of three years or an extension of one year;

ii. An applicant must be engaged in an activity listed as a pioneer industry or pioneer product; and

iii. An applicant must provide evidence of all required legal and regulatory compliance documentation.

11.5 Application guidelines for pioneer status incentives (PSI) by the Federal Ministry of Industry, Trade and Investment (2017)

Based on the guidelines issued by the Federal Ministry of Industry, Trade and Investment in 2017, application for pioneer status incentive can be made by a company incorporated in Nigeria or by a group of persons on behalf of a company which is to be incorporated later. The application shall be on a prescribed form.

Every such application shall state the grounds upon which the applicant relies and if the application is for the issue of a pioneer certificate to any company, the applicant shall:

a. State whether the company is, or the proposed company when incorporated, shall be an indigenous-controlled company;

b. Give particulars of the assets on which qualifying capital expenditure will be incurred by the company, including their source and estimated cost: on or before production day, and during a period of three years following the production day;

c. Specify the place in which the assets are to be situated;

d. State the probable production day;

e. Specify any product and by-product (not being a pioneer product) to be produced, and give a reasonable estimate of the quantities and value, of such product and by-product during a period of one year from production day;

f. Give particulars of the loan and share capital (or proposal in this regard) including the amount and date of each issue and the source from which the capital is to be or has been raised;

g. In the case of a company already incorporated, give the name, address and nationality of each director and the number of shares held by him/her; and

h. In the case of a proposed company, give the name, address and nationality of each promoter of the company.

11.6 Procedure for Application for Pioneer Status Incentives (PSI)

Based on the guidelines issued by the Federal Ministry of Industry, Trade and Investment in 2017, the steps to be taken by a new applicant are as follows:

11.6.1 Procedure for applying and obtaining pioneer status - new application

The following are the step-by-step process for the initial application for PSI:

a. Applicant is expected to write to NIPC, thereafter:
   i. Download guidelines application form and presentation format;
   ii. Request date to present project to NIPC; and

iii. Provide project profile indicating pioneer industry/product, share capital and non- current tangible assets.

b. Present project

This will involve:

i. Agreeing presentation date with the NIPC;

ii. Present project: Following notification of a company's interest to make a new PSI application, the company will be required to make a project presentation to NIPC, covering all the topics listed below:

- Company overview

  This will include: company history; organisational, board, management and shareholding structure;
- Project overview

  This will include: sector overview; sector opportunity; description of project; description of production or service delivery process; key competitors; SWOT analysis; objectives for seeking PSI;
- Project impact

  This will include: economic diversity and growth; industrial and sectorial development; employment; skills and technology transfer; export development; import substitution; environmental, social and governance policies and plans;
- Financial analysis

  This will include: project cost; financing sources; 5-year projected profit or loss, cash flow and statement of financial position; 5-year projected tax savings and utilisation; and

iii. NIPC provides feedback and request payment of application and due diligence fee within a week.

c. Make fee payment

At this point, applicant will be required to make payment of application and due diligence fee to NIPC. The following are the specific fees payable by applicant:

i. Application fee: N200,000

This is a non-refundable fee and it is payable via REMITA prior to submission of Part I of pioneer status incentive application form;

ii. Due diligence fee of N500,000

This is payable via REMITA together with the application fee for new applications prior to submission of Part I of pioneer status incentive application form. Fee covers flights, accommodation and subsistence for three NIPC staff to visit an applicants' project. The applicant is responsible for transporting all NIPC staff between the airport or bus station, the project location, and their accommodation;

iii. Service charge deposit of N2,500,000

This is also payable via REMITA upon notification to applicant of an approval in principle; and

iv. Annual service charge

This is 1% of actual pioneer profits. This is payable to NIPC annually via REMITA, not later than June 30, every year.

It is important to note that both due diligence fee and service charge deposit are deductible from the total service charge, over the pioneer period. However, if no profit is made during the pioneer period, all fees are non-refundable.

Also, please note that the NIPC shall make a monitoring and evaluation visit to the applicants' project. The applicant is only responsible for transporting three NIPC staff between the airport or bus station, the project location and their accommodation. No fee is payable to NIPC for the monitoring and evaluation visit.

d. Submit application

The application form for new PSI applications is in two parts:

Part I

This is to be submitted to NIPC in soft or hard copy with supporting documents, following project presentation and upon payment of fees. The submission should include the following, amongst others:

(i) Formal covering letter to the Executive Secretary of NIPC;
(ii) Company information;
(iii) Company contact information;
(iv) Company external representative;
(v) Project overview
(vi) Project cost;
(vii) Financing sources;
(viii) Shareholders, directors and management;
(ix) Production and financial performance;
(x) Number of employees and emolument;
(xi) Training cost;
(xii) Skills and technology transfer;
(xiii) Raw materials and components;
(xiv) Export earnings and destinations;
(xv) Infrastructure developed;
(xvi) Environmental, social and governance policies and plans;
(xvii) Utilisation of tax savings;
(xviii) 5-year business plan; and
(xix) Declaration signed by Chief Executive Officer/Managing Director.

Part II

This is to be submitted to IID in soft or hard copy with supporting documents, following receipt of an approval in principle. The submission should include the following, amongst others:

(i) Formal covering letter to Director of IID;
(ii) Production record;
(iii) 7-months' sales revenue record;
(iv) 7-months' cash flow record;
(v) Machinery and equipment;
(vi) Energy and water requirements;

(vii) Environmental impact assessment; and
(viii) Declaration signed by Chief Executive Officer/Managing Director.

It is important to note that detailed information of all supporting documents required are to be listed in the relevant application form. Therefore, submission of incomplete information and/or documentation will affect the application process timeline.

e. Due Diligence Visit
   (i) For new PSI applications, two visits will be made to the company's project and these include:
   - Verification visit
     Following evaluation and internal due diligence on a company's application, 2 to 3 NIPC staff shall visit the company's project to verify the information provided in its application. If required, NIPC may request for the company to furnish it with additional information during the verification visit.
   - ii. Inspection visit
     Following evaluation of a company's application for production day certification, 2 to 3 IID staff shall visit the company's project to inspect and gather information for the determination of its production day.

   (ii) For PSI extension applications, one visit will be made to the company's project Monitoring and evaluation visit.
   Following evaluation and internal due diligence on a company's application for extension, 2 to 3 NIPC staff shall visit the company's project to verify the information provided in its application. If required, NIPC may request for the company to furnish it with additional information during the monitoring and evaluation visit.

f. NIPC makes decision on application and notify company of decision and request payment of service charge deposit within one week.

g. Pay service charge deposit
   Company makes payment of service charge deposit and sends payment confirmation to NIPC.

h. Approval in principle
   NIPC issues approval in principle and sends duplicate by email to applicant. The applicant can also elect to receive by courier or collection in person.
   NIPC will also send copies of approval in principle to FIRS, IID and state ministries.

i. Apply for production day certificate
   Applicant is required to:
   - Complete part 11 of application form; and
   - Submit application form to IID in soft or hard copy.

j. Production day determination
   IID in determining the production day, the applicant shall do the following:
   - Reviews application for completeness;
   - Requests inspection visit;
   - Visits project; and
   - Determines production day.

k. Production day certificate
IID shall issue production day certificate and send duplicate by email to applicant. The applicant can also elect to receive by courier or collection in person. IID shall notify the NIPC.

l. Pioneer status incentive certificate
NIPC shall issue PSI certificate and send duplicate by email to applicant. The applicant can also elect to receive by courier or collection in person. The NIPC will also send a copy of the PSI certificate to FIRS and IID.

11.6.2 Procedures for applying and obtaining extension pioneer certificate

The following are the step-by-step process for application for extension of PSI:

a. Applicant is expected to write to NIPC, thereafter, the applicant is to:
   i. Download guidelines, extension form and presentation format; and
   ii. Request for date to present the project to NIPC;

b. Present project
This involves:
   i. Agreeing presentation date;
   ii. Presenting project
A company making an application for PSI extension will be required to make a presentation on the topics listed in the initial application as well as highlighting any material changes since the company was initially granted PSI.; and
   iii. Immediately after such presentation, NIPC will provide feedback on the project to the company, ahead of payment of fees and submission of the relevant application form and supporting documents.

c. Make fee payment
Applicant shall make payment of application and due diligence fee to NIPC. The following are the specific fees payable by the applicant:
   i. Application fee of N100,000; and
   ii. Annual service charge of 1% of actual pioneer profits.

d. Submit application
The application form for PSI extension applications is in one part and is to be submitted to NIPC in soft or hard copy with supporting documents, following project presentation on extension and upon payment of fees.
The submission should include the following, amongst others:
   (i) A formal covering letter addressed to the Executive Secretary of NIPC;
   (ii) Certificate of qualifying capital expenditure issued by FIRS;
   (iii) Company information;
   (iv) Company contact information (if different);
   (v) Company external representative (if different);

(vi) Project overview (if different);
(vii) Total direct investment;
(viii) Production and financial performance;
(ix) Number of employees and emolument;
(x) Training cost;
(xi) Skills and technology transfer;
(xii) Raw materials and components;
(xiii) Export earnings and destinations;
(xiv) Environmental, social and governance policies and plans;
(xv) Utilisation of tax savings;
(xvi) 5-year business plan; and
(xvii) Declaration signed by Chief Executive Officer/Managing Director.

It is important to note that detailed information of all supporting documents required are listed in the relevant application form. Therefore, submission of incomplete information and/or documentation will affect the application process timeline.

e. Due Diligence
The NIPC shall do the following:
i. Review application;
ii. Request date for monitoring and evaluation visit; and
iii. Visit project.

f. Decision
NIPC makes decision on application.

g. Pioneer status incentive certificate
The NIPC will issue PSI extension certificate and sends duplicate by email to the applicant. However, the applicant can elect to receive the PSI certificate by courier or collect in person from NIPC. NIPC will also send a copy to FIRS and IID.

11.6.3 Issuance of certificates

(a) **New pioneer status incentive applications**

The two certificates that will be issued to a company with a qualifying project are as follows:

(i) **Production day certificate**

After the determination of a project's production day by IID, it will issue a production day certificate to the company. A duplicate copy of the certificate will be sent to the company and request for the company to elect to receive the original copy of the certificate by courier or to collect it in person.

(ii) **Pioneer certificate**

When a copy of the production day certificate from IID is received by the company, NIPC will issue a pioneer certificate to the company and request for the company to elect to receive the original copy of the certificate by courier or to collect it in person.

The pioneer certificate will state the period over which the pioneer status incentives (PSI) is valid.

(b) **Pioneer status incentive extension certificate**

The two certificates that will be issued to a company with a qualifying project are as follows:

(i) **Certificate of qualifying capital expenditure**

This is issued to the company by the FIRS prior to applying for PSI extension within a month before the expiration of the initial PSI period.

If there is any dispute between the Revenue Service (FIRS) and the company in connection with the certification of the qualifying capital expenditure, such shall be subject to objection and appeal procedures as if the certificate were a notice of assessment given under the provisions of CITA.

(ii) **Pioneer extension certificate**

NIPC will issue a pioneer extension certificate to a company after the decision to extend a company's pioneer status incentive has been approved. The company is expected to elect to receive the original copy of the certificate by courier or to collect it in person. Usually, the pioneer extension certificate states the period over which the PSI extension is valid.

11.7 Procedure for the amendment of pioneer certificate

The procedure is as follows:

The application for the amendment of pioneer certificate must be in writing;

It must state the reasons for such application;

It must state any additional products or by-products as the case may be; and

Where the application is approved, the original pioneer certificate may be amended to have retrospective effect.

11.8 Retrospective operations

Pioneer certificate could be operated retrospectively. Where a pioneer certificate is to be operative from a retrospective date, then any act which has been done or which has happened but which would not have happened if the pioneer certificate has been in force shall be treated as not having been done or not have happened. If the act consists of payment of tax by a company certified to be a pioneer company, that tax shall, as soon as may be after the expiration of the three months from production day of that company, be repaid to the company by the Service.

11.9 Date of production day certificate

Once the production day is approved, a production day certificate will be issued. Thus, a production day certificate is that certificate issued by the Industrial Inspectorate Division of the Federal Ministry of Industry, Trade and Investment specifying the day on which the pioneer status of a company commenced.

The production day is therefore the date in which the pioneer period is deemed to commence. It is the day when production commenced in commercial quantity.

Importance of the production day certificate

These include:

a. It is the day when the tax-free period starts to run;

b. The qualifying capital expenditure of the company must not fall below the statutory minimum on that day; and

c. It must be certified by the Inspectorate Division of the Federal Ministry of Industry, Trade and Investment as the date when the company starts production in commercial quantity.

11.10 Cancellation of pioneer certificate

The pioneer certificate issued to any company can be cancelled if:

a. Where the production day is extended for more than one year later than the date stated in the company's original application for a pioneer certificate. However, the Council will not cancel the certificate for this reason if it is satisfied that the delay is due to causes outside the control of the company or to other good and sufficient cause;

b. Where the values of the qualifying capital expenditure as on the production day is less than the prescribed minimum value applicable to the company;

c. The pioneer company concerned applies for the cancellation of the certificate

d. A pioneer company has contravened any other provision of the IDA or has failed to fulfill any estimate or proposal made in itsapplication for a pioneer certificate or any of the conditions contained in its pioneer certificate; and

e. A pioneer company fails to submit the annual performance report for any year, shall result in the PSI certificate being cancelled; removal of the company's name from the list of beneficiaries (posted on NIPC website); and notification to FIRS for collection of tax for the unexpired period as well as the period for which the report was not submitted.

NIPC shall reserve the right to proceed with the cancellation of a beneficiary's PSI certificate following two reminders sent to the company's registered address and/or correspondence email address provided in its application form or most recent annual performance report.

Effective date of cancellation

If the period for which the company has been in business under the pioneer status is less than one year, the effective date of cancellation shall be the production day. For example, if the date of granting of the pioneer status is 1/1/2018, the effective date of cancellation in this case shall be 1/1/2018.

If the company has been in business for a period that is more than one year from the date of acquiring the pioneer status, the effective date of cancellation shall be the date of the last anniversary. For example, if the date of pioneer status is 1/1/2017 and date of cancellation is 25/7/2019. In this case, the effective date of cancellation shall be 1/1/2019.

11.11 Income tax relief period

A company holding a pioneer certificate shall be on a tax holiday for the period stated on the certificate. The tax relief period is usually for a period of three years in the first instance, commencing on the date of
the production day of the company, unless cancelled or restricted in any manner by the council.

If certain requirements are met, the council may, at the end of the three years extend the tax relief period for:

Two periods of one year each; or One period of two years.

A pioneer company wishing to obtain such extension, shall apply in writing within one month of the expiration of the initial three years tax relief period or of any extension thereof. Such application shall contain details of all capital expenditure incurred by the company by the requisite date. The requisite date is the date of expiry of a pioneer certificate.

11.12 Conditions for extension of pioneer period

The conditions for the extension of a pioneer status are:

(a) The application must be in writing addressed to the Nigerian Investment Promotion Commission (NIPC);
(b) The application must reach the NIPC not later than one month after the expiration of the initial tax relief period;
(c) The particulars of all capital expenditure incurred by the company by that date must be stated;
(d) The NIPC must be satisfied as to the rate of expansion, standard of efficiency and the level of development of the company;
(e) The NIPC must also be satisfied as to the use of local raw materials and the training and development of Nigerian personnel;
(f) The relative importance of the industry in the economy of the nation; and
(g) The fulfillment of any other condition as may be laid down by the Minister of Finance.

11.13 Tax incentives available to pioneer industries

These include:

(a) The profit of a pioneer company during the pioneer period is exempted from tax;

(b) Any amount of loss or net loss incurred by the pioneer company during pioneer period shall be available for relief against other periods. Net loss is the aggregate of losses of the pioneer period;

(c) The qualifying capital expenditure incurred during the pioneer period is not subject to capital allowance computation during the pioneer period. They are deemed to be incurred on the first day of the post-pioneer period;

(d) The provision for the commencement of a new business is applied on the profit of the post-pioneer period in arriving at the assessable profit; and

(e) Dividend paid out of pioneer profit shall not be chargeable to tax in the hands of the recipient.

11.14 Commencement and cessation provisions to pre-and post pioneer period

(a) A trade or business carried on by a pioneer company shall be deemed to have permanently ceased at the end of its tax relief period.

(b) In respect of that trade or business, the pioneer company shall be deemed to have set up and commenced a new trade or business on the day next following the end of its tax relief period.

(c) The pioneer company shall make up accounts of its old trade or business for the following:

(i) A period not exceeding one year commencing on its production day;

(ii) Successive periods of one year thereafter; and

(iii) A period not exceeding one year ending at the date when its tax relief period ends.

(d) The closing figures in respect of the pioneer company's assets and liabilities as shown in the last accounts in respect of its tax relief period shall be used as the opening figures for the accounts of the company's new trade or business which is deemed to have commenced immediately after the company's tax relief period; and

(e) Capital expenditure incurred by the pioneer company in respect of assets acquired during the tax relief period shall for capital allowances purposes be deemed to have been incurred on the day next following the end of its tax relief period.

11.15 Treatment of losses and capital allowances of pioneer period

(a) Losses

Where the Revenue Service is satisfied that a pioneer company has incurred a loss in any accounting period within the tax relief period, it shall issue a certificate to the company accordingly (IDA Section10 (6)).

In determining whether such a loss has been made, the Revenue Service may in its absolute discretion exclude such sum as may be in excess of an amount appearing to the Revenue Service to be just and reasonable in respect of:

(i) Remuneration to directors of the company; and
(ii) Interest, service, agency or other similar charges made by a person who is a shareholder of the company or by a person controlled by such shareholder (IDA Section 13(3)).

A net loss incurred by a pioneer company shall be deemed to have been incurred by the company on the day on which its new trade or business commences, that is, on the day following the expiry of the tax relief period (IDA Section 14(3)).

For each accounting period, the Revenue Service shall issue to the pioneer company a statement showing the amount of the income or loss for that period.

Net loss means the aggregate of losses incurred during the tax relief period after deduction of profits, if any, made at any time during that period.

Any dispute between the Revenue Service and the company with regards to the statement of income or loss issued by the Revenue Service shall be subject to objection and appeal in like manner as if such statement were an assessment under CITA.

(b) **Capital allowances**

No capital allowance shall be claimed during the pioneer period.

Qualifying capital expenditure incurred prior to or during the pioneer period shall be brought forward to the new trade or business and shall be deemed to have been acquired on the first day of the new trade or business.

11.16 Restriction applicable to pioneer industries

(a) **Non-pioneer product during pioneer period**

If during the pioneer period, a pioneer company also deals in products other the pioneer product. any profit derived from such a transaction cannot be exempted from taxation despite the fact that the transaction is taking place during the pioneer period. In essence, the tax exemption period is applicable only to pioneer products for which the pioneer certificate was originally granted.

(b) **Restrictions on dividends distribution and on the granting of loans (Section 18)**

During its tax relief period, a pioneer company shall not:

(i) Make any distribution to its shareholders, by way of dividend or bonus, in excess of the amount by which the account maintained for the exempt profits is in credit at the date of such distribution; and

(ii) Grant any loan without first obtaining the consent of the Minister. The consent of the Minister shall only be given if he is satisfied that the pioneer company is obtaining adequate security and a reasonable interest for any such loan.

11.17 Obligations of pioneer status incentive beneficiaries

The following are the obligations of a beneficiary of pioneer status incentive (PSI):

(a) **Submission of annual performance report**

This report is to be submitted not later than June 30 of the following calendar year. The report shall provide actual audited financial information and the following:

i. Formal covering letter to the Executive Secretary of NIPC;

ii. Company and project information (if different);

iii. Production and financial performance;

iv. Number of employees and emolument;

v. Training cost;

vi. Skills and technology transfer;

vii. Raw materials and components;

viii. Export earnings and destinations;

ix. Infrastructure developed;

x. Environmental, social and governance projects;

xi. Utilisation of tax savings;

xii. Declaration signed by Chief Executive Officer/Managing Director; and
xiii. Evidence of payment of fees.

(b) **Implications of non-submission of annual performance report include:**

(i) Cancellation of PSI certificate;
(ii) Removal of the company's name from the list of beneficiaries (posted on NIPC website); and
(iii) Notification to FIRS for collection of tax for the unexpired period as well as the period for which the report was not submitted.

Notwithstanding the above, the NIPC shall reserve the right to proceed with the cancellation of a beneficiary's PSI certificate following two reminders sent to the company's registered address and/or correspondence email address provided in its application form or most recent annual performance report.

(c) **Payment of fees**

Applicants for PSI are required to pay all fees due within the stipulated timeframe. The applicable NIPC service fee schedule shall be made available on the websites of FMITI and NIPC.
Failure to make fee payment shall result in the same implication as non-submission of annual performance report.

All fees are to be paid into NIPC's account only (payment details shall be provided on NIPC's service fee schedule).

Pursuant to sections 8-25 of the Corrupt Practices and other Related Offences Act, 2000, any proven act of corruption, gratification or inducement in violation of the said Act would be inimical to and jeopardise the prospect of being granted or retaining a PSI approval and certificate, in addition to being referred to the relevant agency of the FGN for investigation and possible prosecution. This is in line with the FGN strict zero tolerance policy for corruption.

(d) **Impact assessment**

The NIPC shall carry out periodic PSI impact assessment surveys. Therefore, beneficiary companies; that is, PSI companies are required to furnish the NIPC with any relevant information requested.
The NIPC shall publish the PSI impact assessment report on its website with data presented in an aggregated format.

(e) **Compliance with IDA and application guidelines for PSI:**

Beneficiaries of PSI are required to comply with the provisions of the IDA and conditions set out in the PSI application guidelines.

11.18 Production day

Subsection (1) of Section 6 of IDA requires that not later than one month after the material date, a pioneer company shall make an application in writing to the Industrial Inspectorate Director to certify the date of its production day. The company shall propose a date to be so certified and give reasons for proposing that date.

Once the production day is approved, a production day certificate will be issued. Thus, a production day certificate is that certificate issued by the Industrial Inspectorate Division of the Federal Ministry of Industry, Trade and Investment specifying the day on which the pioneer status of a company commenced.

The production day is therefore the date in which the pioneer period is deemed to commence. It is the day when production commenced in commercial quantity.

Importance of the production day certificate

a. It is the day when the tax-free period starts to run.

b. The qualifying capital expenditure of the company must not fall below the statutory minimum on that day.

c. It must be certified by the Inspectorate Division of the Federal Ministry of Industry, Trade and Investment as the date when the company starts production in commercial quantity.

Material date

Material date on the other hand means:

a. In relation to a pioneer company engaged in the provision of services, the date on which the company is ready to provide such services on a commercial scale; and

b. In relation to a pioneer company engaged in a manufacturing, processing, mining, agricultural or any other pioneer industry, the date on which the company begins to produce a pioneer product in marketable quantities.

11.19 Income tax relief

A company holding a pioneer certificate shall be on a tax holiday for the period stated on the certificate. The tax relief period is usually for a period of three years in the first instance, commencing on the date of the production day of the company, unless cancelled or restricted in any manner by the Council.

If certain requirements are met, the Council may, at the end of the three years extend the tax relief period for:

- Two periods of one year each; or
- One period of two years.

A pioneer company wishing to obtain such extension, shall apply in writing within one month of the expiration of the initial three years tax relief period or of any extension thereof. Such application shall contain details of all capital expenditure incurred by the company by the requisite date. The requisite date is the date of expiry of a pioneer certificate.

11.20 Taxable profits

Any profit earned by a pioneer company from any operations or activities whatsoever, other than its pioneer enterprises shall be deemed to be derived from Nigeria and shall be liable to tax under CITA.

11.21 Service charge

A service charge of 1% of pioneer profits is payable to Nigeria Investment Promotion Commission (NIPC) annually via REMITA, not later than June 30, every year.

11.22 Exempt profits

Any profits shown on the statement issued by the Revenue Service in respect of the income of a pioneer company for each of the accounting periods of its tax relief period, shall not form part of the assessable profits or total profits of the pioneer company for any year of assessment and shall be exempt from tax under CITA – (IDA Section 16).

11.23 Dividend distribution

Any amount of profits that is exempt from tax as above should be credited by the pioneer company to an account to be kept for the purpose of dividend distribution by the company.

Any dividend that is declared by the company out of such profits shall be exempt from tax in the hands of the shareholders and shall for the purposes of CITA and PITA be deemed to be paid out of profits on which tax is not paid or payable.

Restrictions on dividends distribution and on the granting of loans (Section 18).

During its tax relief period, a pioneer company shall not:
(a) Make any distribution to its shareholders, by way of dividend or bonus, in excess of the amount by which the account maintained for the exempt profits is in credit at the date of such distribution.
(b) Grant any loan without first obtaining the consent of the Minister. The consent of the Minister shall only be given if he is satisfied that the pioneer company is obtaining adequate security and a reasonable interest for any such loan.

11.24 Pioneer industries and products on the pioneer list

S/n	Industries	Products
1.	Cultivation, processing and preservation of food crops and fruits.	Preserved canned foodstuff and fruits, tea, coffee, refined sugar, tomato puree/juice etc.
2.	Integrated dairy production	Butter, cheese, fluid milk and powder, ice cream (by products, livestock, minor edible products).
3.	a) Deep sea trawling and processing b) Coastal fishing and shrimping	Preserved sea foods, fish and shrimps, fishmeal
4.	Mining lead, zinc, and iron and steel from iron ore	Iron and steel products
5.	Manufacture of iron and steel from Iron ore	Iron and steel products
6.	The smelting and refining of non-ferrous base metal and the manufacture of their alloys	Refined non-ferrous base metal and their alloys
7.	Mining and processing of barytes, bentonites and associated minerals	Barytes, bentonites and associated minerals
8.	Manufacture of glass and glassware	Sheet glass, pharmaceuticals and laboratory glasswares
9.	Manufacture of lime from local limestone	Lime
10.	Quarrying and processing of marbles	Marbles and processed marbles
11.	Manufacture of ceramic products	Refractory and heat insulating constructional products,

S/n	Industries	Products
		laboratory ware
12.	Manufacture of basic and intermediate Industrial chemicals from predominantly Nigerian raw materials	i) Basic and intermediate organic chemical; ii) Basic and intermediate in-organic chemicals; iii) Fertilizers; iv) Petro-chemical; v) Caustic soda and chlorine vi) Pesticide and insecticide
13.	Formulation and manufacture of pharmaceuticals	Pharmaceuticals, health vitamins
14.	Manufacture of yeast, alcohol and related products	Yeast, industrial alcohol and related products
15.	Manufacture of paper pulp	Paper pulp
16.	Manufacture of yarn and man-made fibres	Yarn and synthetic fibres
17.	Manufacture of machinery involving the local manufacture of substantial proportion of components thereof	Office and industrial machinery, equipment and apparatus (whether or not electrical)
18	Manufacture of products made wholly or mainly of mental	Pipes and tubes structure metal products
19.	Manufacture of nets from local raw materials	Fishing nets, mosquito nets and related products
20.	Manufacture of gas cylinders	Gas cylinders
21.	The processing of local wheat flour materials	Flour and offal
22.	Rubber plantation and processing	Rubber
23.	Gum/arabic plantation and processing	Gum arabic
24.	Manufacture of fertilizers ammonia, urea	Superphosphate and nitrogenous fertilizers
25.	Vehicle manufacture	Motor vehicles and motor-cycles, tri-cycles and automotive components
26.	Oil palm plantation and processing	Palm oil, palm kennel and offals
27.	Manufacture of automotive and other components	Automotive and other components.
28.	Book printing	Books
29	Large scale mechanized farming	Wheat, maize, rice and sorghum
30.	Cattle ranching and piggery of not less than 500 herds	Cattle and pigs of not less than 500 herds
31.	Manufacture of gypsum	Gypsum
32.	Re-refining or re-cycling of waste oil	Low power oil
33.	Manufacture of electrical appliances/ equipment/components and parts	Generators, transformers, meter, control, pressing irons, switchgears, test equipment, ballets/ starters/ lighters, discreet components, resistor/capacitors/coils/semi-conductors/ conductors.
34.	Ship building, repairs and maintenance of ocean going vessels	Ships, boats and barges.
35.	Manufacture of computer and computer chips	Computer hard and soft ware chips
36.	Manufacture of cameras, photographic	Cameras, photographic equipment or any component

S/n	Industries	Products
	equipment and other materials	thereof
37.	Diving and underwater engineers	Underwater engineering services.
38.	Local fabrications of machinery, equipment	Machinery
39.	Manufacture of tools	Machines and hand tools
40.	Installation of facilities for aircraft manufacture and maintenance of aircraft	Aircraft maintenance and manufacture
41.	Installation of scientific instruments and communication equipment	Scientific instruments, radio, audio play-back/recorders, loudspeaker units, amplifying systems, microphones, video playbacks/ recorders, PBX, telephone handset, tele-printers, trans-receivers, autophones/aerials.
42.	Manufacture of gas and distribution	Gas and gas distribution
43.	Manufacture of solar energy powered equipment and gadgets	Solar panels, refrigerators, water pumps, calculators, etc
44.	Large-scale inland fishing farms	Fish and shrimps
45.	Bitumen mining and processing	Bitumen
46.	Salt production	Salt
47.	Manufacture of fire fighting equipment and detection systems	Fire fighting equipment and detection systems
48.	Manufacture of cables	Electrical, telephone and other cables
49.	Manufacture of medical equipment	X-ray, oxygen equipment, etc
50.	Mineral oil prospecting and production	Petroleum
51.	Manufacture of lubricants	Grease, hydraulic/engine oil, gear oil, etc
52.	Manufacture of flat sheets	Flat sheets
53.	Manufacture of oven, cookers, cold rooms, refrigerators, fridges, freezers, air conditioner	Oven, cookers, cold rooms, refrigerators, fridges, freezers, air conditioner
54.	Manufacture of agricultural machinery and equipment	Ploughs, harvesters, threshers, planters etc
55.	Manufacture of materials handling and equipment	Cranes, forklifts etc
56.	Establishment of foundries	Moulds, casting, etc
57.	Manufacture of alum	Alum
58.	Manufacture of enzymes	Enzymes
59.	Manufacture of concentrates	Food/fruits concentrates
60.	Manufacture of welding electrodes	Welding electrodes
61.	Manufacture of nails	Nails, related items
62.	Manufacture of iron rods	Rods from billets
63.	Manufacture of hops	Brewing hops
64.	Information and communication technology (ICT)	Manufacture/production of ICT equipment, hardware and software
65.	Tourism	Development of holiday resorts, hotels, sporting and recreational facilities
66.	Real estate development	Rental income from residential and commercial premises;

S/n	Industries	Products
		Capital gains from any real estate disposed of within a specified period
67.	Utility services	Independent power generation utilizing gas, coal and renewable energy sources. All aspects of transportation such as rail, road and waterways. Indigenous telecommunications companies other than GSM operations.

List of new industries added to pioneer list

1. Mining and processing of coal;
2. Processing and preservation of meat/poultry and production of meat/poultry products;
3. Manufacture of starches and starch products;
4. Processing of cocoa;
5. Manufacture of animal feeds;
6. Tanning and dressing of leather;
7. Manufacture of leather footwear, luggage and handbags;
8. Manufacture of household and personal hygiene paper products;
9. Manufacture of paints, vanishes and printing ink;
10. Manufacture of plastic products (builders' plastic ware) and moulds;
11. Manufacture of batteries and accumulators;
12. Manufacture of steam generators;
13. Manufacture of railway locomotives, wagons and rolling stock;
14. Manufacture of metal-forming machinery and machine tools;
15. Manufacture of machinery for metallurgy;
16. Manufacture of machinery for food and beverage processing;
17. Manufacture of machinery for textile, apparel and leather production;
18. Manufacture of machinery for paper and paperboard production;
19. Manufacture of plastics and rubber machinery;
20. Waste treatment, disposal and material recovery;
21. E-commerce services;
22. Software development and publishing;
23. Motion picture, video and television programme production, distribution, exhibition and photography;
24. Music production, publishing and distribution;
25. Real estate investment vehicles under the Investments and Securities Act;
26. Mortgage backed securities under the Investments and Securities Act; and
27. Business process outsourcing.

11.25. Tax incentives for small and medium sized companies engaged in primary agricultural production - Provisions of Finance Act, 2020

The Finance Act, 2020 included primary agricultural production as a pioneer product to qualify for an initial tax – free period of four (4) years, renewable for additional maximum period of two (2) years subject to satisfactory performance.

Qualifying companies are limited to small and medium sized companies only, pursuant to an application to the President, through the Minister.

Such companies shall not be granted a similar incentive under any other Act in Nigeria.

The definition of small and medium sized companies and primary agricultural production is as defined in CITA as amended by Finance Acts, 2019 and 2020.

11.26 Offences and penalties

11.26.1 Offences

The offences specified in IDA are:

(a) Making or presenting any declaration or statement which is false in any material particular; and

(b) Production of any invoice or undertaking which is false in any material particular or has not been given by the person by whom it is purported to have been given or which has been altered or tampered with.

The defense available to any person charged is to be able to prove he has taken all reasonable steps to ascertain the truth of the statement made or contained in any document so presented or produced or to satisfy himself of the genuineness of the invoice or undertaking.

11.26.2 Penalties

Any person who is guilty of any of the above offences, shall be liable on conviction to a fine not exceeding ₦1,000 or to imprisonment for five years or to both such fine and imprisonment.

Where the offence is committed by a body corporate, or firm or other association of individuals:

(a) Every director, manager, secretary or other similar officer of the body corporate;

(b) Every partner or officer of the firm;

(c) Every person concerned in the affairs of the association; or

(d) Every person who was purporting to act in any such capacity as aforesaid, shall severally be guilty of that offence and liable to be prosecuted and punished for the offence in like manner as if he had himself committed the offence.

The defense available to any of such persons is to be able to prove that the act or omission constituting the offence took place without his knowledge, consent or connivance. The above shall not relieve any person from liability to payment of any sum for which he is or may be liable under any undertaking given by him under any provision of the IDA.

11.27 Nigeria LNG limited

The Nigeria LNG (Fiscal Incentives, Guarantees & Assurances) Act No. 39 of 1990 (amended by Act 113 of 1993) was promulgated to encourage productive disposal of associated gas and development of gas wells. The Decree applies to Nigeria LNG Limited alone.The incentives granted to the company are:

(a) The company is declared a pioneer company and its products pioneer products;

(b) Ten years tax relief period;

(c) All interests payable are allowable deductions for tax purposes without any condition;

(d) Interests on foreign loans are exempt from taxation in Nigeria;

(e) The books and records of the company shall be kept in United States dollars and the accounts there from shall be drawn in the same currency;

(f) Dividends are exempt from tax (like dividends payable by any other pioneer company from profits made during the tax holiday);

(g) Import duties exemption on necessary imports; and

(h) No capital allowances restriction after its tax relief period.

In 2003, pioneer status was granted to certain companies operating in the telecommunication industry.

11.28 Chapter review

In this chapter, the various provisions of the Industrial Development (Income Tax Relief) Act (IDA) and the guidelines issued by the Federal Ministry of Trade and Investment in 2017, have been covered with regards to pioneer industries and pioneer companies. Conditions for applying for a pioneer status incentive have also been discussed.

The tax implications of a company that has been granted a pioneer status and the accounts to be prepared and submitted to the tax office for the purpose of claiming the benefits available to the pioneer company have been treated. Finally, the profits and dividends of a pioneer company are tax exempt.

11.29 Worked examples

11.29.1 Open-ended Questions

(1) New Idea Processing Co. Ltd. was established in 2008 and commenced its cocoa processing business on July 1, in the same year.

The adjusted profits of the company are as stated below:

		₦	
Period to	September 30, 2009	600,000	Loss
Year ended	September 30, 2010	1,500,000	Profit
Year ended	September 30, 2011	2,750,000	Profit

Capital allowances for the relevant years of assessment were computed and agreed with the Federal Inland Revenue Service as follows:

₦

2008 Year of assessment	750,000
2009 Year of assessment	600,000
2010 Year of assessment	700,000
2011 Year of assessment	550,000
2012 Year of assessment	480,000

Required:
Determine the tax liability of the company for all the relevant years. Please note that the company was denied pioneer status.

2. Jayne Nigeria Limited was incorporated on 3 March 31, 2014 to manufacture a pioneer product. It was granted a pioneer certificate with a production day certified to be June 1, 2014.

You are given the following information.

	₦
Net profit for the year ended May 31, 2018	1,540,000
Depreciation charged for year ended May 31, 2018	132,14

Capital expenditure incurred up to and including year ended May 31, 2017 certified by the tax office are as follows:

	₦
Motor vehicles	1,250,000
Plant and machinery	1,425,000
Industrial buildings	1,890,000
Non-industrial buildings	920,000
Accumulated profit at May 31, 2017	725,000

It is not the intention of the directors to apply for an extension of the pioneer period.

Required:
Compute the tax liabilities for the relevant assessment years.

3. With respect to Industrial Development (Income Tax Relief) Act, discuss the following:

(a) Treatment of Losses and capital allowances of pioneer period
(b) Restriction on trading prior to end of tax relief period
(c) Restriction on distribution of dividend and granting of loans
(d) Provision for plantation industry
(e) Accounting periods

4. (a) Part of the amendments introduced by the Finance Act, 2019 was the classification of companies in Nigeria while Finance Act, 2020 also defined primary agricultural production.

You are required to:

(i) Explain small and medium sized companies in the context of Finance Act, 2019 and what constitutes primary agricultural production in the context of Finance Act, 2020.

(ii) Within the context of Industrial Development (Income tax relief) Act and the provisions of Finance Act, 2020, discuss the tax incentives for small and medium sized companies engaged in primary agricultural production.

(b) Discuss the circumstances that could lead to cancellation of pioneer certificate issued to a company in Nigeria.

11.29.2 Suggested solutions to open-ended Questions

(1) New Idea Processing Co. Ltd. Income tax computation

Date of commencement of business –July 1, 2008
Commencement provisions:

Assessment Year	Without election Basis period	With election Basis period
2008	1/7/2008 to31/12/2008	1/7/2008 to31/12/2008
2009	1/7/2008 to 30/6/2009	1/1/2009 to31/12/2009
2010	1/10/2008 to 30/9/2009	1/1/2010 to31/12/2010
2011	Year ended 30/9/2010	Year ended 30/9/2010
2012	Year ended 30/9/2011	Year ended 30/9/2011

Without election

	₦	₦
2008		
6/15 x ₦600,000 Loss c/f		(240,000)
Therefore, 2008 Assessment Capital allowance unutilised c/f	750,000	NIL
2009		
12/15 x 600,000 loss		(480,000)
Therefore, 2009 Assessment		NIL
Loss b/f	240,000	
For 2009 assessment year	480,000	
	720,000	
Loss c/f cannot exceed the amount of the actual loss incurred. Therefore, loss c/f		₦600,000
Capital allowances:		
For year	600,000	
Brought forward	750,000	

Carried forward	1,350,000	
2010 12/15 x ₦ 600,000 Loss		(480,000)
Therefore, 2010 assessment		NIL
Capital allowances		
For year	700,000	
Brought forward	1,350,000	
Carried forward		2,050,000
Loss c/f can still not exceed the actual loss incurred. Therefore, Loss c/f		600,000

2011		
Adjusted profit for the year ended 30/9/2010		1,500,000
Less loss relief – Loss b/f		600,000
		900,000
Less Capital allowances:		
For year	550,000	
Brought forward	2,050,000	
	2,600,000	
Amount that can be relieved	(900,000)	(900,000)
C.A. unrelieved c/f	1,700,000	
	₦	₦
2011 Assessment NIL		
2012		
Adjusted profit for the year ended 30/9/2011		2,750,000
Less Capital allowances:		
For year	480,000	
Brought forward	1,700,000	(2,180,000)
Chargeable profit		570,000
Income tax at 30% thereof		171,000

With election to have 2 and 3 years of assessment based on actual, the assessments for 2009 and 2010 assessment years would be:

	₦	
2009 – 1/1/2009 to 31/12/2009		
9/15 x (N600,000) +		
3/12 x N1,500,000 profit		
= (N360,000) + N375,000 profit	15,000	profit
2010 – 1/1/2010 to 31/12/2010		
9/12 x 1,500,000 + 3/12 x N2,750,000		
= N1,125,000 + N687,500	1,812,500	profit

Notes:

(a) Taking the two years together will give total assessable profits of ₦1,827,500. Based on election as against NIL assessable profit without election. It is not to the taxpayer's advantage to elect

(b) Cocoa processing will fall into the business of manufacturing, hence no restriction of capital allowances.

2. **Jayne Nigeria Limited**
Income tax computations for 2017, 2018 and 2019

Assessment years

	₦	₦
Net profit for the year ended May 31, 2018	1,540,000	
Add: Depreciation		132,145
Adjusted profit for the year		1,672,145
2017 Assessment year		
Actual for the 7 months (7/12 x N1,672,145)		975,418
Deduct: Capital allowances		
Investment allowance	142,500	
Initial allowance	1,759,000	
Annual allowance	334,382	
(2,235,882)		
Un-recouped capital allowance c/f		(1,260,464)
Total profit		Nil

	₦	₦
Income tax liability at 30%		Nil
Tertiary education tax at (2% of N975,418)		₦19,508
2018 Assessment year		
First 12 months of operation (12/12 x N1,672,145)		1,672,145
Deduct: Capital allowances		
B/f from 2017 Assessment year	1,260,464	
For the year	573,225	(1,833,689)
Unrecouped Capital allowances c/f		(161,544)
Total profit	Nil	
Income tax liability at 30%		Nil
Tertiary education tax (at 2% of ₦1,672,145)		33,443
2019 Assessment year		
Preceding year basis (12/12 X ₦1,672,145)		1,672,145
Deduct: Capital allowances		
B/F from 2018 Assessment year	161,544	
For the year	573,225	734,769
Total profits		937,376

Income tax liability (at 30% of ₦937,376)	281,213
Tertiary education tax (at 2% of ₦1,672,145)	33,443

Workings
Jayne Nigeria Limited

Capital allowance computations

	Motor vehicle	**Plant & machinery**	**Industrial building**	**Non-industrial building**	**Total**
Allowances rates:					
Investment		10%			
Initial	50%	50%	15%	15%	
Annual	25%	25%	10%	10%	
2017 Assessment year					
(7 Months)	₦	₦	₦	₦	₦
Cost	1,250,000	1,425,000	1,890,000	920,000	5,485,000
Investment allowance	142,500				142,500
Initial allowance	(625,000)	(712,500)	(283,500)	(138,000)	(1,759,000)
	₦	₦	₦	₦	₦
Balance after Initial allow. (A)	625,000	712,500	1,606,500	782,000	3,726,000
Annual allow. Full year	156,250	178,125	160,650	78,200	
A. A. claim for 7/12 (B)	(91,146)	(103,906)	(93,713)	(45,617)	(334,382)
WDV c/f to 2018 (A-B) 533,854	608,594	1,512,787	736,383	3,391,618	
2018 Assessment year					
Deduct Annual allowance	(156,250)	(178,125)	(160,650)	(78,200)	(573,225)
WDV c/f to 2019	377,604	430,469	1,352,137	658,183	2,818,393
2019 Assessment year					
Deduct Annual allowance	(156,250)	(178,125)	(160,650)	(78,200)	(573,225)
WDV c/f to 2000	221,354	252,344	1,191,487	579,983	2,245,168

Note: Investment allowance at 10% is due on qualifying expenditure on plant and machinery.

3. (a) **Treatment of Losses and capital allowances of pioneer period Losses**

Where the Revenue Service is satisfied that a pioneer company has incurred a loss in any accounting period within the tax relief period, it shall issue a certificate to the company accordingly. (IDA Section10 (6).

In determining whether such a loss has been made, the Revenue Service may in its absolute discretion exclude such sum as may be in excess of an amount appearing to the Revenue Service to be just and reasonable in respect of:

(iii) Remuneration to directors of the company;

(iv) Interest, service, agency or other similar charges made by a person who is a shareholder of the company or by a person controlled by such shareholder (IDA Section 13(3)).

A net loss incurred by a pioneer company shall be deemed to have been incurred by the company on the day on which its new trade or business commences, that is, on the day following the expiry of the tax relief period (IDA Section 14(3)).

For each accounting period, the Revenue Service shall issue to the pioneer company a statement showing the amount of the income or loss for that period.

Net loss means the aggregate of losses incurred during the tax relief period after deduction of profits, if any, made at any time during that period

Any dispute between the Revenue Service and the company with regards to the statement of income or loss issued by the Revenue Service shall be subject to objection and appeal in like manner as if such statement were an assessment under CITA.

Capital allowances

No capital allowance shall be claimed during the pioneer period

Qualifying capital expenditure incurred prior to or during the pioneer period shall be brought forward to the new trade or business and shall be deemed to have been acquired on the first day of the new trade or business.

(b) Prior to the expiration of its tax relief period, a pioneer company shall not carry on any trade or business other than a trade or business, the whole of the profit of which are derived from its pioneer operations. Where, prior to the expiration of its tax relief period, any profit earned by the pioneer company from any of its operations and activities whatsoever other than from its pioneer business, shall be deemed for the purposes of the Act, to be derived in Nigeria and shall be liable to tax.

(c) During its tax relief period, a pioneer company shall not:

(i) Make any distribution to its shareholders by way of dividends or bonus in excess

of the amount by which the account to be kept by the company is in credit at the date of any such distribution.

(ii) Grant any loan without first obtaining the consent of the Minister, which shall only be given if he is satisfied that the pioneer company is obtaining adequate security and a reasonable rate of interest for any such loan.

(d) For the purpose of the trade of a company which operates a plantation and to which a pioneer certificate has been granted, shall be deemed to have “Commenced” on the date when planting first reaches maturity, and any expenditure incurred on the maintenance of a planted area up to that date, shall be deemed to have brought unto existence an asset, and the expenditure shall be qualifying plantation expenditure for the purpose of the Act.

(e) The accounting period shall be:

- A period not exceeding one year, commencing on its production day
- A successive period of one year thereafter
- A period not exceeding one year ending at a date when its tax relief period ends.

(4) (i) In line with the provisions of Finance Act, 2019, small companies are companies whose annual gross turnover is N25,000,000 or less while medium sized companies are companies with annual gross turnover that is greater than N25,000,000 but less than N100,000,000.

The Finance Act, 2020 defined primary agricultural production to mean:

(a) Primary crop production comprising the production of raw crops of all kinds,' but excluding any intermediate or final processing of crops or any other associated manufactured or derivative crop product;

(b) Primary livestock production comprising the production of live animals and their direct produce such as live or raw meat, live or raw poultry, fresh eggs and milk of all kinds, but excluding any other associated manufactured or derivative livestock product;

(c) Primary forestry production comprising the production of timbers of various kinds such as firewood, charcoal, uncultivated materials gathered and other forestry products of all kinds, including seeds and saplings, but excluding the intermediate and final processing of timber and any other manufactured or derivative timber product; and

(d) Primary fishing production comprising the production of fish of all kinds, including ornamental fish, but excluding any intermediate or final processing of any other manufactured or derivative fish product.

(ii) The Finance Act, 2020 included primary agricultural production as a pioneer product to qualify for an initial tax –free period of four (4) years, renewable for additional maximum period of two (2) years subject to satisfactory performance.

Qualifying companies are limited to small and medium sized companies only, pursuant to an application to the President, through the Minister.

Meanwhile, such companies shall not be granted a similar incentive under any other Act in Nigeria.

The definition of small and medium sized companies and primary agricultural production is as defined in CITA as amended by Finance Acts, 2019 and 2020 respectively.

(b) The pioneer certificate issued to any company can be cancelled if:

(i) The production day is extended for more than one year later than the date stated in the company's original application for a pioneer certificate. However, the council will not cancel the certificate for this reason if it is satisfied that the delay is due to causes outside the control of the company or to other good and sufficient cause;

(ii) The values of the qualifying capital expenditure as on the production day is less the prescribed minimum value applicable to the company;

(iii) The pioneer company concerned applies for the cancellation of the certificate;

(iv) A pioneer company has contravened any other provision of the IDA or has failed to fulfill any estimate or proposal made in its application for a pioneer certificate or any of the conditions contained in its pioneer certificate; and

(v) A pioneer company fails to submit the annual performance report for any year, shall result in the pioneer status incentive (PSI) certificate being cancelled; removal of the company's name from the list of beneficiaries (posted on NIPC website); and notification to FIRS for collection of tax for the unexpired period as well as the period for which the report was not submitted. NIPC shall reserve the right to proceed with the cancellation of a beneficiary's PSI certificate following two reminders sent to the company's registered address and/or correspondence email address provided in its application form or most recent annual performance report.

12

Other tax incentives

Contents

Other tax incentives

12.0 Purpose

After studying this chapter, readers should be able to:

(a) Understand tax incentives;

(b) Know various forms of tax incentives available to taxpayers in Nigeria; and

(c) Understand the rationale for tax incentives and the negative effects of tax incentives.

12.1 Introduction

Taxation is one of the powerful tools which a progressive government can use to great advantage in achieving set fiscal objectives. Tax incentives are those special exclusions, exemptions or deductions from income or tax credits offered to taxpayers by the government as an encouragement to engage in specified activities. Tax incentives can be used to attract local or foreign investment capital to certain activities or particular areas in a country.

Tax incentives in Nigeria are meant to:

a. Encourage voluntary tax compliance;

b. Attract domestic and foreign investments into Nigeria;

c. Encourage businessmen to invest in certain preferred sectors of the economy;

d. Encourage investment to develop rural areas and export processing zones (EPZ);

e. Promote export activities;

f. Encourage repatriation of foreign earnings to Nigeria;

g. Encourage research and development activities;

h. Encourage and accelerate the growth of small-scale businesses; and

i. Encourage businesses to make financial contributions to activities which the government considers socially desirable.

Tax incentives may be granted on industry basis or by tax type and may include:

(i) Exemption from payment of taxes.

(ii) Reduction in rate of tax to be paid.

(iii) Grant of allowances and deductions from profits subject to tax, etc.

12.2 Incentives for gas utilization as provided under the companies income tax act (CITA) – Section 39 of CITA

A company engaged in gas utilization (downstream operations) shall be granted the following incentives:

(a) An initial tax free period of three years which may subject to the satisfactory performance of the business be renewed for an additional period of two years. This tax free period shall start on the day the company commences production as certified by the Ministry of Petroleum Resources

(b) As an alternative to the initial tax free period granted under (a) above, an additional investment allowance of 35 percent which shall not reduce the value of the asset. However, a company that claim this shall not be entitled to claim investment allowance of 15 percent

(c) Accelerated capital allowance after the tax relief period as follows:

i. an annual allowance of 90 percent with 10 percent retention for investment in plant and machinery

ii. an additional investment allowance of 15 percent which shall not reduce the value of the asset

(d) Tax free dividend during the tax free period where:

i. the investment for the business is in foreign currency

ii. the introduction of imported plant and machinery during the period was not less than 30 percent of the equity share capital of the company

(e) Interest payable on loan obtained with the prior approval of the Minister for a gas project shall be deductible.

12.2.1 Provision of Finance Act, 2020 on Incentives for gas utilization

The Finance Act, 2020 amended section 39(1) to grant the incentives only to companies whose trade or business involves gas utilization in downstream operations

The mere consumption of gas does not qualify for the claim of this incentive

The tax-free period is to start on the day the trade or business commence production as certified by the Ministry of Petroleum Resources (MPR).

A company which had claimed incentive for the trade or business of gas utilization under any law including PPTA and IDITRA is barred from claiming this incentive.

The erstwhile restriction based on intention to claim this incentive has now been removed

12.3 Tax incentives for manufacturing, agricultural and exports business

Fiscal measures that have been drawn to provide for deductions and allowances in the determination of taxable income of manufacturing, agricultural and export business are:

Pioneer Status
This is a concession to pioneer companies located in economically disadvantaged areas, providing a tax holiday period of three to five years. These industries must be considered by the government, to be beneficial to the country's economy and in the interest of the public.

Companies that are involved in local raw material development; local value added; labour intensive processing; export-oriented activities; in-plant training; are also qualified for additional concessions.

Tax relief for research and development (R&D)
Up to 120% of expenses on R&D are tax deductible provided that such R&D activities are carried out in Nigeria and are connected with businesses to which allowances are granted. The result of such research could be patented and protected in accordance with internationally accepted industrial property rights.

Local raw materials utilisation
30% tax concession for five years to industries that attain minimum local raw materials utilisation as follows: agro - 80%; agro allied - 70%; engineering - 65%; chemical - 60%;and petro-chemical - 70%.

Labour intensive mode of production:
15% tax concession for five years. The rate is graduated in such a way that an industry employing one thousand persons or more will enjoy 15% tax concession while an industry employing one hundred will enjoy only 6%, while those employing two hundred will enjoy 7%, and so on.

Local value added
10% tax concession for five years. This applies essentially to engineering industries, while some finished imported products serve as inputs. This is aimed at encouraging local fabrication rather than the mere assembly of completely knocked down parts.

In-plant training
2% tax concession for five years, of the cost of the facilities for training.

Export oriented industries
10% tax concession for five years. This concession will apply to industries that export not less than 6% of their products.

Infrastructure
20% of the cost of providing basic infrastructure such as roads, water, electricity, where they do not exist, is tax deductible once and for all.

Investment in economically disadvantaged areas
100% tax holiday for seven years and additional 5% depreciation over and above the initial capital depreciation.

Excise Duty
Excise Duty is defined by the Excise Ordinance No. 64 of 1941 as "any duty other than export duty of customs imposed on any goods manufactured in Nigeria".

Excise duty is the money paid to the government by manufacturing concerns for goods produced. It is a production tax. The tax can also be levied on intangible items such as internet data and telecommunication fees.

It was abolished with effect from 1 January 1999 but was immediately reintroduced the following year.

Goods liable to excise duty are:

- Beer and stout
- Wines
- Spirits
- Cigarettes and tobacco that are manufactured and sold in Nigeria.

Import duty rebate
A 25% import duty rebate was introduced in 1995 to ameliorate the adverse effect of inflation and to ensure increase in capacity utilisation in the manufacturing sector. Investors are however, advised to ascertain the current operative figures at the time of making an investment, because these concessions have undergone some amendments in the past few years.

Re-investment allowance
This incentive is given to manufacturing companies that incur capital expenditure for purposes of approved expansion of production capacity; modernisation of production facilities; diversification into related products. It is aimed at encouraging reinvestment of profits in productive capacity.

Investment tax allowance
Under this scheme, a company would enjoy generous tax allowance in respect of qualifying capital expenditure.

Dividends derived from manufacturing companies in petro-chemical and liquefied natural gas sub-sector are exempt from tax.

Companies with turnover of less than ₦1 million are taxed at a low rate of 20% for the first five years of operation, if they are into manufacturing.

Investment guarantees/effective protection
Transferability of funds: Section 24 of NIPC decree provides that a foreign investor in an enterprise shall be guaranteed unconditional transferability of funds through an authorised dealer in freely convertible currency of:

(a) Dividends or profit (net of taxes) attributable to the investment;

(b) Payments in respect of loan servicing where a foreign loan has been obtained;

(c) Remittance of proceeds (net of all taxes)and other obligations in the event of a sale or liquidation of the enterprise; or

(d) Any interest attributable to the investment.

Guarantees against expropriation
By the provisions of section 25 of the same Nigeria Investment Promotion Commission Act, no enterprise shall be nationalised or expropriated by any government of the Federation, unless the acquisition is in the national interest or for public purpose; and no person who owns either wholly or in part, the capital of any enterprise shall be compelled by law to surrender his interest in the capital to any other person.

These can only be done under a law that makes provision for:

(a) Payments of fair and adequate compensation; and

(b) Right of access to the courts for the determination of the investor's interest or right and the amount of compensation to which he is entitled.

In addition to all these safeguards, the Nigerian government is prepared to enter into investment protection agreement with foreign enterprises wishing to invest in Nigeria.

Access to land
Any company incorporated in Nigeria is allowed to have access to land rights for the purpose of its activity in any state in the country.

It is, however, a requirement that industrial companies comply with regulations on use of land for industrial purposes and with environmental regulations. Land lease is usually for a term of 99 years, unless the company stipulates a shorter duration.

Tax Waiver on Bonds
[Companies Income Tax (Exemption of Bonds and short-term Government Securities) Order 2011].

The interest earned by the holders of the following bonds and securities are exempt from companies income tax for 10 years, effective from 2 January 2012.

(a) Short-term Federal Government securities such as treasury bills and promissory notes;

(b) Bonds issued by Federal, State and Local Governments and their agencies;

(c) Bonds issued by corporate and supra-nationals.

Public Infrastructure and Employment Relief
[Companies Income Tax (Exception of Profit) Order, 2012] The commencement date was27 April 2012 and lasted for 5 years subject to the specific conditions under each incentive.

(a) **Public infrastructure incentive:** 30% of the cost of infrastructure of a public nature will be granted as a tax-deductible expense. To qualify, the infrastructure should be completed and available for public use, except where impracticable or an exemption is obtained from the Ministry of Finance.

(b) **Employment generation incentive:** Tax deduction of the lower of 5% of assessable profit or new employees' salaries can be claimed. To qualify, a company must have a minimum net employment of ten staff in the assessment period. At least 60% of the net employment should relate to new graduates.

(c) **Staff retention incentive:** Tax deduction of 5% of assessable profits is available. To qualify, a company must have a minimum net employment of 5 and must have retained the employees for at least 2 years from the year of assessment when they were first employed.

Net Employment: means the difference between incoming and outgoing employees of the company in an assessment period.

Executive order 007 – Companies Income Tax (Road Infrastructure Development and Refurbishment Investment Tax Credit Scheme) Order 2019

The Scheme is a public-private partnership, which enables private companies fund the construction and refurbishment of eligible roads in Nigeria. In return, participants in the Scheme are entitled to recover the project funds by way of tax credits, claimable against Companies Income Tax (CIT) payable.

The Scheme will be implemented and administered by a special management committee (the Committee), consisting of representatives from relevant Ministries and agencies, including Federal Inland Revenue Service (FIRS) and chaired by the Minister of Finance.

The Scheme is open to Nigerian companies (other than corporation sole), institutional investors and a pool of companies operating through a special purpose vehicle set up as an infrastructure fund. Eligible road refers to any road approved by the President as eligible for the Scheme on the recommendation of the Minister of Finance and as duly notified to participants.

The primary benefit of this Scheme to participants is the ability to recover the project cost as tax credit against CIT payable. This credit is represented by the Road Infrastructure Tax Credit (RITC). RITC covers:

- Project cost (any expenditure wholly, reasonably, exclusively and necessarily incurred by a participant for the construction or refurbishment of an eligible road as quoted by the participant in its project cost bid and as certified by the Committee); and
- A single uplift (similar to interest), which is equivalent to the prevailing monetary policy rate (MPR) of the Central Bank of Nigeria (CBN), plus 2% of the project cost. The uplift (income) would not constitute taxable income in the hands of a participant.

The Scheme will be in force for a period of 10 years from the date of commencement in January 2019.

Incentives to ECOWAS Countries [ECOWAS Trade Liberalisation Scheme (ETLS)]

Approved products manufactured by beneficiaries of the ETLS are allowed free access to markets within the ECOWAS region without any import duties in the destination countries.

Products approved for the scheme must satisfy the rules of origin which require at least 60% local raw materials content (volume) or 40% local raw materials value (monetary) or a minimum of 35% local value added. The cost, insurance and freight (CIF) value of imported raw material must not exceed 60% of the total cost of raw materials used.

ETLS is not fully operational, going by the low level of implementation by member countries.

12.4 Petroleum industry

Very similar generous incentives package was granted the joint venture system and is contained in the MOU signed with oil companies.

12.5 Agriculture

Without prejudice to government deregulation of the financial sector, banks have been enjoined to recognise the differences in the gestation periods within each category of agricultural loans ranging from 6 months to 10 years, for crops, livestock, fisheries, forestry and wildlife.

In addition, the following incentives are also available;

(a) Companies in the agro-allied business do not have their capital allowances restricted to 60% but graduated in full - 100%;

(b) Agro-allied plant and equipment enjoy enhanced capital allowances of up to 50%.

12.6 Solid Minerals

Nigeria is richly endowed with solid minerals of various categories, ranging from precious metals, stones and industrial minerals such as barytes, gypsum, kaolin and marble.

The Ministry of Solid Minerals has worked out a package of attractive incentives for potential investors in the solid minerals sector,including:

(a) 3 to 5 years tax holiday;

(b) Deferred royalty payments depending on the magnitude of the investment and strategic nature of the project;

(c) Possible capitalisation of expenditure on exploration and surveys;

(d) Provision of 100% foreign ownership of mining companies or concerns; and

(e) In addition to roll-over relief under the capital gains tax (CGT), companies replacing their plants and machinery are to enjoy a once-and-for-all 95% capital allowance in the first year with 5% retention value until the asset is disposed of, etc.

12.7 Tourism

The tourism sector was accorded preferred sector status in 1991. This makes it qualify for such incentives as tax holidays, longer years of moratorium and import duty exemption on tourism related equipment;

State governments are prepared to facilitate acquisition of land through the issuance of certificate of occupancy for the purpose of tourism development;

25% of income derived from tourists by hotels in convertible currencies are tax-exempt provided such income is put in a reserve fund to be utilised within 5 years for expansion or the construction of new hotels, conference centres, etc that are useful for tourism development.

12.8 Energy sector

All areas of investment in this sector are considered to be pioneer product or industry. As a result, there is a tax holiday of 5 to 7 years for investments in the sector.

There has been a deregulation of this sector resulting in the emergence of independent power producers (IPP) that will soon start operation in Nigeria.

12.9 Telecommunications

Government provides non-fiscal incentives to private investors in addition to a tariff structure that ensures that investors recover their investment over a reasonable period of time, bearing in mind the need for differential tariffs between urban and rural areas. Rebate and tax relief are provided for the local manufacture of telecommunications equipment and provision of telecommunication services.

12.10 Tax incentives for other lines of trade

Companies' profits in respect of goods exported from Nigeria, are exempt from tax, provided the proceeds are repatriated to Nigeria and used exclusively for the purchase of raw materials, plants, equipment and spare parts. Profits of companies whose supplies are exclusively input to the manufacturing of products for exports, are excluded from tax.

All new industrial undertakings including foreign companies and individuals operating in an export processing zone (EPZ), are allowed full tax holidays for three consecutive years.

As a means of encouraging industrial technology, companies and other organisations that engage in research and development activities for commercialisation are to enjoy 20% investment tax credit on their qualifying expenditure.

All companies engaged wholly in the fabrication of tools, spare parts and simple machinery for local consumption and export are to enjoy 25% investment tax credit on their qualifying capital expenditure while any tax payer who purchases locally manufactured plants and machinery are similarly entitled to 15% investment tax credit on such fixed assets bought for use.

12.11 Export incentives for non-oil sector

Export proceeds

Export proceeds can be retained in foreign currency in a domiciliary account with any authorised bank in Nigeria.

Special Export Development Fund

A special export development fund has been set up by the government to provide financial assistance to private sector export companies to cover a part of their initial expenses in some export promotion activities, including training courses, symposia, seminars and workshops, export market research, advertising and publicity campaigns in foreign markets, trade missions, etc.

Export Adjustment Fund

There is also an export adjustment fund scheme which serves as supplementary export subsidy to compensate exporters for the high cost of local production arising mainly from infrastructural deficiencies, and other negative factors beyond the control of the exporter.

Export Processing Zones (EPZ) Reliefs

These are zones designed to grant incentives to export oriented companies, mostly in the manufacturing sector. The following are industries permitted:

- Oil and gas logistics
- Electrical and electronic products
- Textile products
- Garments
- Wood products and handicraft
- Leather products
- Petroleum products
- Rubber and plastic products
- Cosmetics and other chemical products
- Metal products and machinery
- Educational materials and sports equipment
- Printing materials, communication and office equipment
- Medical kits, optical instruments and appliances
- Biscuits, confectioneries and other food processing
- Pharmaceutical products

- Ship building and repairs.

Proposals for industries outside the above listings will be considered on their individual merits.

Locating an industry in any Free Zone in Nigeria automatically confers upon the investor certain advantages, benefits and incentives which have been strategically designed by the Federal Government of Nigeria to create a business-friendly environment for the investor and to be competitive.

These incentives, established by Act No. 63 of 1992 and which have been improved even more in subsequent legislation, are the following:

(a) Complete holiday from all federal, state and local government taxes, rates and levies.

(b) Duty free importation of capital goods, machinery/components, spare parts, raw materials and consumable items in the zones.

(c) 100% foreign ownership of investments.

(d) 100% repatriation of capital, profits and dividends.

(e) Waiver of all imports and export licences.

(f) Waiver on all expatriate quotas.

(g) One-stop approvals for permits, operating license and importation papers.

(h) Permission to sell 100% of goods into the domestic market (However, when selling into the domestic market, applicable customs duty on imported raw material shall apply).

(i) For prohibited items in the custom territory, free zone goods are allowed for sale provided such goods meet the requirement of up to 35% domestic value addition.

(j) Waiver on all expatriate quotas for companies operating in the zones.

(k) Minimise delays in the movement of goods and services.

(l) Rent-free land during the first 6 months of construction (for government owned zones).

12.12 Benefits and criticisms of tax incentives

12.12.1 Benefits:

There are benefits derived from tax incentives, though, it is said to play only a minor role in influencing investment decision into a country. Some of them are;

(a) Tax incentives can be used to attract investment into the country as an indication to the reluctant foreigner that he is needed, welcomed and would be well treated.

(b) It is a convenient tool to attract industries that will help to solve unemployment problem.

(c) It improves the commercial profitability of investment by making available tax-free income within the tax holiday period, which is re- invested in the establishment of other industries.

(d) It also serves to establish a favourable investment climate and provide the desired assurance against confiscation and against non-convertibility especially in developing countries, including Nigeria where there are different problems like currency restrictions, instability of government and the risk that foreign capital investment may be expropriated etc.

(e) Tax incentives help in drawing attention to the profit prospects of investing in certain types of business that a country seeks to promote.

(f) It is also necessary to compete in the international capital market

(g) It also increases the profit prospects of a new venture and enables a firm to recover its capital costs faster, so that the risks of investment are reduced considerably.

Having looked at some beneficial aspects of tax incentives, we will now look at some criticisms levelled against them.

12.12.2 Criticisms of tax incentives

(a) The use of tax incentives has been criticised on the ground that most tax incentives laws are new, and empirical studies of their operations are so scanty. Thus, it is not possible to present a definitive appraisal of their contributions to new investments and it is not possible to measure the cost of tax incentives against the benefits received.

(b) It is criticised as being an ineffective and inefficient stimulus to investment, especially in developing countries, as it complicates the regular company or business tax legislation, and tax shelters made available to taxpayers through all sorts of means are veritable
sources of tax avoidance and/or evasion for a "smart" taxpayer who may take advantage of the yawning loopholes that may result there from.

(c) It has also been criticised on the ground that if a tax system believes in the sanctity of endless provision of shelters, there will be no end to the erosion of the statutory tax base of such a tax system. According to Seyi Ojo, this is made worse by the government sacrificing its revenue base on the altar of political gains.

(d) It has been criticised that the resultant proliferation of tax holiday and the keen competition among developing countries especially in offering tax incentives for new investments has to a greatextent diluted its promotional value.

(e) The grant of tax incentives has been criticised because it is said to be disproportionate as the benefit derived vary from firm to firm and as such, firms that are more profitable will likely enjoy more benefits than those with little or no profit has been countered by SeyiOjo, who said that if the most profitable business enjoys more benefits, there is nothing wrong as it should encourage other firms to work hard towards being profitable, which will enhance the nation's wealth.

(f) It is also said that such large benefits to highly profitable businesses will result in serious loss of revenue to the government which is almost always short of revenue. It has in fact, been reported by Adetoun Phillips, that the cumulative effect of the incentives provided in Nigeria between 1958 and 1966 was a loss of revenue equivalent to four percent (4%) of the total revenue of government.

12.12 Tax implications of operations in the free trade zones

Incentives and fiscal measures approved by the government that favour and encourage large investment in the free trade zones include:

(a) No personal income tax;

(b) 100% repatriation of capital and profit;

(c) No foreign exchange regulation;

(d) No pre-shipment inspection for goods imported into the free zone;

(e) No expatriate quota;

(f) Tax holiday;

(g) Investment capital allowance; and

(h) All dividends distributed during the tax holiday shall be tax-free

12.12.1 Requirements for claiming tax incentives by companies operating in free trade zone

In line with the provisions of Finance Act, 2020, for companies registered and operating in the free trade zones to claim various tax incentives, such companies shall comply with the provisions of section 55 (I) of the Companies Income Tax Act and render returns in the manner prescribed therein, to the Federal Inland Revenue Service and all penalties prescribed in the Companies Income Tax Act and the Federal Inland Revenue Service (Establishment) Act that may apply in the event of non- compliance with section 55 (I) of the Companies Income Tax Act shall apply to such companies in the event of default to comply.

In summary, companies operating in free trade zones will be exempted from taxes only when they comply with tax filing and returns obligations to the FIRS under section 55(1) of CITA (as amended).

12.14 Chapter review

This chapter discusses tax incentives, their objectives and variants of tax incentives available to businesses in Nigeria. The benefits and demerits of tax incentives were also discussed.

Readers must have learnt how the Finance Act 2020 impact on some of the incentives available to companies in Nigeria.

12.15 Worked examples

12.15.1 Open-ended Questions

(1) The quest by various governments in Nigeria since 1990s to use tax incentives to change the narrative of being a mono-product foreign exchange earner has attracted interests from both local and foreign investors to the hitherto forgotten non-oil sector. However, some of the foreign investors are not conversant with these tax incentives available to investors in the manufacturing, mining and telecommunication industries.

You have been appointed as a tax consultant to a Russian billionaire through his agent in Nigeria, JIM Associates, with interests in many sectors such as agriculture, aviation, manufacturing and telecommunication in Europe. He intends to explore the Nigerian business environment within the next one year.

Required:

You are to write a report to the Russian billionaire through his agent in Nigeria highlighting the following areas:

a. Objectives of Nigerian tax incentives

b. Forms of tax incentives

c. Various tax incentives available to operators in the:

i. Manufacturing sector
ii. Agriculture
iii. Telecommunications

d. Other non-tax factors foreign investors consider in determining a jurisdiction as investment destination.

(2) Mr. Chijioke who studied in Canada and had been working there for over 25 years finally returned to Nigeria in 2016.

He has made some savings to start a new business and incorporated Chijioke Investments Limited in January 2017. However, since returning to the country, he has been inundated with stories of start-up and existing businesses that closed shop as a result of harsh economic conditions.

Mr. Chijioke has read in newspapers that as a result of government‟s determination to facilitate ease of doing business in Nigeria, the Federal Government has periodically been reviewing and improving on the reliefs and incentives available to corporate taxpayers. This has raised a ray of hope in Mr. Chijioke and he is eager to have more information to avoid pitfalls.

Given his reservation about the current business climate in Nigeria:

a. Explain briefly SIX reliefs and incentives available to corporate taxpayers.

b. Outline THREE conditions a company must fulfill to qualify for tax incentives for export oriented business.

(3) Tax incentives are special exclusions, exemptions or deductions from income and profit or tax credits offered to taxpayers by the Government as an encouragement to engage in specified activities or undertakings. In this context, the Federal Government of Nigeria through various Executive orders has been rolling out series of tax incentives to taxpayers in Nigeria over the years.

You are required to discuss the operation of the following tax incentives:

a. Road Infrastructure Development and Refurbishment Investment Tax Credit Scheme
b. Employment Tax Relief (ETR)
c. Work Experience Acquisition Programme Relief
d. Infrastructure Tax Relief (ITR)

12.15.2 Suggested solutions to open-ended questions

(1)

KAK Professional Services
(Tax Consultants)
22, Ikorodu Road, Lagos

December 9, 2020

The Managing Partner
JIM Associates
44, Broad Street, Lagos

Dear Sir,

RE: NIGERIAN TAX INCENTIVES

I refer to your letter with Reference Number JIM/12/20 dated December 7, 2020 engaging our firm to provide professional advice on the above subject. Our comments are as follows:

a) **Objectives of tax incentives**

Tax incentives in Nigeria are meant to:

(i) Encourage voluntary tax compliance;
(ii) Attract domestic and foreign investments into Nigeria;
(iii) Encourage businessmen to invest in certain preferred sectors of the economy;
(iv) Encourage investment to develop rural areas and export processing (EPZ);
(v) Promote export activities;
(vi) Encourage repatriation of foreign earnings to Nigeria;
(vii) Encourage research and development activities;
(viii) Encourage and accelerate the growth of small scale businesses; and
(ix) Encourage businesses to make financial contributions to activities which the government considers socially desirable.

b) **Forms of tax incentives**

The incentives may be granted based on industry or type of tax and may include:

(i) Exemption from payment of taxes;
(ii) Reduction in rate of tax to be paid;
(iii) Grant of allowances and deductions from profits subject to tax, etc; and
(iv) Claiming of reliefs such as loss relief and double taxation relief.

c i) **Manufacturing sector**

Fiscal measures have been drawn to provide for deductions and allowances in the determination of taxable income of manufacturing enterprises. They include:

Pioneer status

This is a concession to pioneer companies located in economically disadvantaged areas by providing a tax holiday period of three to five years. These industries must be considered by the government to be beneficial to the country's economy and in the interest of the public.

Companies that are involved in local raw material development; local value added; labour intensive processing; export–oriented activities; in-plant training; are also qualified for additional concessions;

Tax relief for research and development (R&D)

Up to 120% of expenses on R&D are tax deductible provided that such R&D activities are carried out in Nigeria and are connected with businesses to which allowances are granted.

The result of such research could be patented and protected in accordance with internationally accepted industrial property rights;

Small business income tax rate of 20%
Based on the provisions of the Finance Act 2019, any business with annual gross turnover of N25 million or less turnover is exempted from companies income tax while, any company with annual gross turnover of more N25 million but less than N100 million attracts income tax rate of 20% on total profit;

Local raw materials utilization

30% tax concession for five years to industries that attain minimum local raw materials utilisation as follows: agro – 80%; agro allied – 70%; engineering – 65%; chemical – 60%; and petro-chemical – 70%;

Labour intensive mode of production
15% tax concession for five years. The rate is graduated in such a way that an industry employing one thousand persons or more will enjoy 15% tax concession while an industry employing one hundred will enjoy only 6%, while those employing two hundred will enjoy 7% and so on;

Local value added
10% tax concession for five years. This applies essentially to engineering industries, while some finished imported products serve as inputs. This is aimed at encouraging local fabrication rather than the mere assembly of completely knocked down parts;

In-plant training

2% tax concession for five years, of the cost of the facilities for training;

Export oriented industries
10% tax concession for five years. This concession will apply to industries that export not less than 6% of their products;

Rural investment allowance
This is an allowance given to a company which incurs capital expenditure or the provision of facilities, such as electricity, water and tarred road. The rates are as follows:

No facilities at all (100%); no electricity (50%); no water (30%) and no tarred road (15%).

Investment in economically disadvantaged areas

100% tax holiday for seven years and additional 5% depreciation over and above the initial capital depreciation; and

ii. **Agriculture**

Incentives include;

- General incentive-pioneer status;
- Tax relief for research and development;

- ➢ 30% tax credit for 5 years for agro-allied form that attains maximum level of local raw material utilization of 70%;
- ➢ Effective 2012 YOA, agricultural machinery and equipment attracts no duty;
- ➢ No restriction on the amount of capital allowance claimable in any year of assessment;
- ➢ Agricultural business is exempted from minimum tax provision;
- ➢ Interest on loans granted to agricultural business is exempted from tax provided the moratorium period is not less than 12 months and the interest is not more than the base lending rate at the time it was granted or restructured; and
- ➢ Agro-allied plants and equipment enjoy enhanced capital allowance of up to 50%.

iii. **Telecommunications**

These include:

- General incentive-pioneer status;
- Provision of non-fiscal incentives to private investors in addition to a tariff structure that ensures that investors recover their investment over a reasonable period of time, bearing in mind the need for differential tariffs between urban and rural areas; and
- Rebate and tax relief are provided for the local manufacture of telecommunications equipment and provision of telecommunication services.

d. Non-tax factors considered by foreign investors in locational determinants, will differ from one business to another, depending on the objectives of the investment.

The more important non-tax factors include:

- ✓ Economic and political stability;
- ✓ Adequate physical, business, accounting and legal infrastructure;
- ✓ The absence (or limited presence) of bureaucratic obstacles;
- ✓ Adequate communication channels;
- ✓ Ability to negotiate profit freely;
- ✓ Effective banking system; and
- ✓ The availability of an adequate dispute resolution mechanism.

Please do not hesitate to contact us if you require any further clarification on the above subject.

Yours faithfully,
For : KAK Professional Services

Wale Afolabi
Principal Consultant

(2) a. **Reliefs and incentives available to corporate taxpayers:**

Reliefs are claims or provisions in tax laws which constitute reduction on the amount of assessable profits in the year of assessment under consideration.

Incentives, on the other hand, are claims or provisions in tax laws which seek to reduce the amount of income tax payable in the year of assessment under consideration.

Reliefs available to corporate taxpayers:

i. Loss relief – These are business losses which are only deductible from same business profit indefinitely. The effect of which, is a reduction on the amount of assessable profit in the computation of total profit.

ii. Application of the right of election – A rational taxpayer only applies for the right of election if the total assessable profit for the second and third years of assessment assessed together, on actual year basis is less than what was computed using the normal commencement rule. It is a relief available on commencement of business.

iii. Capital allowance – This is a relief for a company which has incurred qualifying capital expenditure in any year of assessment, for the purpose of the business. Capital allowance will be deducted in full, or restricted as the case may be, from the assessable profit, in order to arrive at the total profit.

iv. Carry backward of unclaimed capital allowance on cessation – This is a relief available to a taxpayer on cessation of business. Any unclaimed capital allowance can be carried backward against the remainder of assessable profit, that of the immediate preceding 5 years. Thus reducing the amount of total profit and the revenue authority makes refund of tax which had been paid by the taxpayer.

v. Roll-over relief – This is where the proceeds on disposal of chargeable assets of a particular class of chargeable asset is re-invested in the acquisition of an asset of the same class. Where roll-over relief is applicable, chargeable gain on the disposal is deferred and the capital gains tax is not computed, depending on the type of roll-over relief whether full, partial or no roll-over.

vi. Investment allowance – This is an additional allowance to the amount of capital allowance already claimed on the qualifying capital allowance. It is also deducted from assessable profit like capital allowance.

Incentives available to corporate taxpayers:

i. Memorandum of understanding (MOU) Credit – This is an incentive available to joint venture operators in the petroleum industry. It is normally deducted from the assessable tax in arriving at the chargeable tax of the year of assessment.

ii. Investment tax credit – This is also available to a production sharing contract operator. It is also used in reducing the assessable tax in order to arrive at the chargeable tax.

iii. Pioneer status – Profit of any company conferred with the pioneer status, will be exempted from tax for initial 3 years and for additional 2 years if extension is sought and granted.

Based on the provisions of the Finance Act 2019, any business with a gross turnover of ₦25 million and below is exempted from companies income tax. While, any company with turnover above ₦25 million but less than ₦100 million attracts income tax rate of 20% on total profit;

v. Exemption from minimum tax – As an anti-avoidance legislation, companies are sometimes expected to pay minimum tax,

However, based on the provisions of the Finance Act 2019, minimum tax is not applicable to the following companies:

- Companies with a gross turnover of less than ₦25 million;
- Companies carrying on agricultural trade or business; and
- Companies in the first four calendar years of its business.

This implies that companies with at least 25% imported equity capital are no longer exempt from the payment of minimum tax according to Finance Act, 2019.

vi. Double taxation relief –This is to mitigate against the effect of double taxation on foreign income, which is subject to foreign tax and Nigerian tax.

vii. Road infrastructure development and refurbishment investment tax credit scheme.

This scheme is a public-private partnership, which enables private companies fund the construction and refurbishment of eligible roads in Nigeria. In return, participants in the scheme are entitled to recover the project funds by way of tax credits, claimable against companies income tax (CIT) payable.

b. **Conditions a company must fulfill to qualify for tax incentives for export - oriented business are as follows:**

i. The company is 100% export oriented;

ii. The company produces or manufactures and exports during the relevant year, and the export proceeds during the year is not less than 75% of total turnover for the year; and

iii. The company repatriates at least 75% of earnings from its exports back to Nigeria, and deposits same in a domiciliary account maintained in a bank in Nigeria.

3 a. **Road infrastructure development and refurbishment investment tax credit scheme**

The scheme is a public-private partnership, which enables private companies fund the construction and refurbishment of eligible roads in Nigeria. In return, participants in the scheme are entitled to recover the project funds by way of tax credits, claimable against companies income tax (CIT) payable.

The scheme will be implemented and administered by a special management committee (the Committee), consisting of representatives from relevant ministries and agencies, including Federal Inland Revenue Service (FIRS) and chaired by the Minister of Finance.

The scheme is open to Nigerian companies (other than corporation sole), institutional investors and a pool of companies operating through a special purpose vehicle set up as an infrastructure fund. Eligible road refers to any road approved by the President as eligible for the scheme on the recommendation of the Minister of Finance and as duly notified to participants.

The primary benefit of this scheme to participants is the ability to recover the project cost as tax credit against CIT payable. This credit is represented by the road infrastructure tax credit (RITC). RITC covers:

- Project cost (any expenditure wholly, reasonably, exclusively and necessarily incurred by a participant for the construction or refurbishment of an eligible road as quoted by the participant in its project cost bid and as certified by the Committee); and
- A single uplift (similar to interest), which is equivalent to the prevailing monetary policy rate (MPR) of the Central Bank of Nigeria (CBN), plus 2% of the project cost. The uplift (income) would not constitute taxable income in the hands of a participant.

The scheme will be in force for a period of 10 years from the date of commencement in January 2019.

(a) Employment tax relief (ETR) :

This is claimable by a company that has minimum net employment of 10 employees (Nigerians) of which sixty percent are employees without any form of previous work experience within three year of graduating from school or any vocation within the assessment period. The relief claimable is 5% of the assessable profits of a company subject to a maximum of 100% of the gross salaries of qualifying employees.

The tax exemption shall be utilized in the year of assessment in which the employees were first employed and any unabsorbed deduction shall not be carried forward to another assessment period. A company shall not be entitled to claim the applicable relief, where it has more than one employee from the same immediate family in respect of which the relief is claimed in which case the required number of employees will be computed less any such member of the same family.
This relief is available effective April 27, 2012 and for five (5) years and certification by the company statutory auditors is also required.

c . Work experience acquisition programme relief

Any company with a minimum net employment of five new employees (Nigerians) and retains such employees for a minimum of two years from the year of assessment in which the employees were first employed shall enjoy an exemption from income tax of five per cent of its assessable profits in the assessment period in which the company qualifies.

The tax exemption shall be utilised in the year of assessment in which the company qualifies and any unabsorbed deduction shall not be carried forward to another assessment period. A company shall not be entitled to claim the applicable relief, where it has more than one employee from the same immediate family in respect of which the relief is claimed in which case the required number of employees will be computed less any such member of the same family.

This relief is available effective April 27, 2012 and for five (5) years and certification by the company statutory auditors is also required.

d. Infrastructure tax relief (ITR)

Any company that incurs expenditure on infrastructure or facilities of a public nature shall be entitled to an exemption from income tax of an additional thirty per cent (**30%**) of the cost of the provision of the infrastructure or facilities in the assessment period in which the infrastructure or facilities were provided. The facilities shall include: power (electricity), roads and bridges, water, health, education and sporting facilities and such other facilities as may be determined by the Minister of Finance on the recommendation of Federal Inland Revenue Service to be of public nature.

To qualify for exemption under this paragraph, the infrastructure or facilities must be completed and in use by the company and the public.

The exemption shall be enjoyed in the assessment period in which the infrastructure or facility was provided and may be carried forward for a maximum of two assessment periods following the period in which it first became available.

This relief is available effective April 27, 2012 and for five (5) years and certification by the company statutory auditors is also required.

13 Capital gains tax

Contents

Capital gains tax

13.0 Purpose

After studying this chapter, readers should be able to:

(a) Know how Capital Gains Tax Act is administered;

(b) Understand the nature and objectives of Capital Gains Tax;

(c) Understand the principle of allowable and disallowable expenditure as applicable to capital gainstax;

(d) Know the chargeable gains that are exempted from capital gains tax;

(e) Understand all the capital gains tax issues involved in acquisition and disposals of assets;

(f) Know the reliefs available in capital gains tax; and

(g) Be able to prepare capital gains tax computations in accordance with the provisions of the Capital Gains Tax Act CAP C1 LFN2004.

13.1 Nature and objectives of capital gains tax

In the usual income tax computations, profits or losses on disposal of fixed assets are excluded by means of adjustments to the relevant accounting results. At the same time, balancing adjustment would be made in the capital allowances computation in respect of the difference between the proceeds of disposal and the tax written down value of such assets. Balancing allowance will be granted if the proceed falls short of the written down value and a balancing charge, if the proceed is higher.

In the latter case, if the proceed is greater than the cost, the amount of the balancing charge would be restricted to the amount of capital allowances previously granted. This will be the difference between the cost of acquisition and the tax written down value of disposal. In such a situation, another surplus, that is, the difference between the proceed and the cost, which has not been subjected to any taxation treatment arises. In taxation law and practice, all transactions of capital nature are excluded from income tax. In view of the fact that the surplus referred to is a capital receipt, it cannot be included in gains or profits for income tax purposes. However, such capital gains are subject to capital gains tax (CGT) under the Capital Gains Tax Act (CGTA).

The Capital Gains Tax Act enacted in 1967, came into effect from the 1967/68 assessment year. In addition to the necessity to charge capital gains to tax as illustrated above, the Act could also have been introduced to produce an additional source of revenue to Government to finance Nigeria's civil war. The principal Act together with all amendments thereto has been re-enacted as Capital Gains Tax Act CAP C1 of the Laws of the Federation of Nigeria (LFN) 2004 (as amended).

13.2 Administration of capital gains tax

The management of the Capital Gains Tax Act with respect to corporate bodies and non-resident individuals (individuals outside Nigeria), is placed under the administration of the Federal Inland Revenue Service. This is with regards to returns, assessments, appeals, collections, recovery and repayments, offences and penalties as well as litigations. The management of the Act with respect to individuals (except non- residents individuals and individuals resident in the Federal Capital Territory, FCT), is placed under the administration of the States' Board of Internal Revenue. The FCT – Internal Revenue Service administer capital gains tax with respect to individuals resident in the Federal Capital Territory (FCT Certain provisions of the "Income Tax Acts" (detailed in a schedule attached to the Capital Gains Tax Act) shall apply in relation to capital gains tax as they apply in relation to income tax chargeable under those Acts subject to any necessary modifications – Section 43(1).

Appeals against any assessment to capital gains tax (CGT) shall be made in accordance with the provisions of CITA or provisions of the PITA as the case may be, to the Tax Appeal Tribunal established under the Companies Income Tax Act.

Capital gains

Capital gains may be defined as gains arising from increases in the market value of capital assets, to a corporate body or person who does not habitually offer them for sale, and in whose hands they do not constitute stock-in-trade.

It is the difference between the consideration accruing and sums excluded from the consideration, being cost and ancillary costs of disposal of a capital asset.

One guiding principle is to examine, the purpose for which an asset is bought and / or sold. Where an asset is acquired and / or kept for use or as an investment, proceeds on the disposal of any such asset shall be treated as a capital receipt and any gain thereon will be regarded as a capital gain. On the other hand, where fixed assets are kept and sold regularly for gains (profits), such disposal proceeds shall be treated as normal income receipts and taxed under the Personal Income Tax Act P8 LFN 2004 (as amended) or Companies Income Tax Act CAP C21 LFN 2004 (as amended).

CGT imposition

The tax is imposed on gains arising out of the ownership of a capital asset changing hands, either by exchange, transfer, sales or gift. The Act as it is presently, is silent on gains arising from the appreciation in value of an asset, which has not changed hands over time. capital gains tax is chargeable on the total amount of the chargeable gains arising after deducting allowable expenses on the disposal of chargeable assets, in a year of assessment.

Year of assessment

A year of assessment in relation to capital gains tax means, a year beginning with January 1 and ending with December 31 in the same calendar year with effect from 1969.This implies that capital gains tax is charged on actual year basis.

13.3 Allowable and disallowable expenditure

Deductions allowable (Section 14)

(a) Cost of acquisition or purchase price, including all costs incidental to the purchase.
(b) Improvement costs wholly, reasonably, exclusively and necessarily incurred.
(c) Cost wholly, reasonably, exclusively, and necessarily incurred in establishing, preserving or defending the owner's title to or a right over the asset.
(d) Incidental costs of disposal.

These include:

i. Fees, commissions or remuneration paid for professional services of surveyor or valuer; auctioneer, accountant: agent and or legal adviser;

ii. Cost of transfer or conveyance (including stamp duties);

iii. Advertisement cost to find a seller/buyer; and

iv. Cost reasonably incurred to make any valuation or apportionment required for the purpose of computing the capital gains including expenses in ascertaining market value where required.

Disallowable expenditure

Sums allowable as a deduction in computing the profits or gains or losses of a trade for income tax purposes are not allowable deduction under Section 14 above (Section 15).

Insurance premiums on the asset are not allowable – Section 16.

13.4 Rate

Capital gains tax (CGT) is chargeable at 10% on capital gains arising from disposal of assets (20% applied up to 31/12/1995).

13.5 Computation of chargeable gains

Gains chargeable

Section 3, CGT Act defined chargeable assets as meaning all forms of property, whether situated in Nigeria or not and including:

(a) Options, debts and incorporeal property generally;

(b) Any currency other than Nigerian currency; and

(c) Any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired;

(d) Stock and shares of every description (excluded from chargeable assets with effect from1/1/1998).

In respect of assets outside Nigeria and

(i) Disposed by non-resident individual, or

(ii) Trustee of any trust or settlement, or

(iii) A company whose activities are managed and controlled outside Nigeria

CGT is chargeable on that part of the gains (if any) received or brought into Nigeria when they are so dealt with (Section 4). This is what is termed 'remittance basis'. The amount of the gains chargeable is dependent on the whole or part which is remitted to Nigeria. If there is no remittance to Nigeria, there is no liability to Capital Gains Tax in respect of the disposals of those fixed assets.

Capital loss on disposal of any asset is not deductible from capital gains on disposal of any other asset even if both are of the same type (Section 5).

13.6 Exemptions from capital gains tax

The following are exempt chargeable gains:

Gains accruing to:

(i) An ecclesiastical, charitable or educational institution of a public character;

According to the Finance Act, 2020 public character for the purpose of tax exemption requires an organisation or institution to be registered in accordance with relevant laws in Nigeria and should not distribute or share its profits in any manner to members or promoters.

(ii) Any statutory or registered friendly society;

(iii) Any cooperative society registered under the Cooperative Societies Law of any State; and

(iv) Any trade union registered under the Trade Unions Act. In so far as the gain is not derived from any disposal of any assets acquired in connection with any trade or business carried on by the institution or society and the gain is applied purely for the purpose of the institution or society as the case may be (Section 27(1).

(a) Gains accruing to any Local Government Council (Section 28(1).

(b) Gains accruing to any company, being a purchasing authority established by or under any law in Nigeria, empowered to acquire any commodity in Nigeria for export from Nigeria; or gains accruing to any corporation established by or under any law for the purpose of fostering the economic development of any part of Nigeria in so far as the gains are not derived from the disposal of any assets acquired by the corporation in connection with any trade or business carried on by it or from the disposal of any share or other interest possessed by the corporation in a trade or business carried on by some person or authority (Section28(2).

(c) Gains accruing on disposal of investments held as part of any superannuation fund or other statutory retirement benefits scheme to the same extent as income derived from the assets would be exempt under Section 20 of PITA (Section29.1).

(d) Disposal of a right to, or any part of any sum payable out of any superannuation fund shall also not be chargeable (Section 29.2) “Superannuation Fund” means a pension, provident or other retirement benefits fund, society or scheme approved by the Joint Tax Revenue Service under Section 21(1)(g) of PITA.

(e) Gains accruing on disposal by any person of a decoration awarded for valour or gallant conduct which he acquires otherwise than for consideration in money or money’s worth (Section 30).

(f) Gains accruing from a disposal of Nigerian Government Securities (Section 31) Nigerian Government Securities include Nigeria treasury bonds, savings certificates and premium bonds issued under the Savings Bonds and Certificates Act.

(g) Gains accruing on disposal of land compulsorily acquired by an authority having and exercising such powers (Section9).

(h) Gains accruing in connection with the disposal of an interest in or the right under any policy of assurance or contract for a deferred annuity on the life of any person (Section33).

Some of the other exemptions and relief provisions in the Act are as follows:

(i) Section 35 exempts sums obtained by way of compensation or damages for any wrong or injury suffered by an individual to his person or in his profession or vocation. This includes wrong or injury for libel, slander or enticement. Sums obtained by way of compensation for loss of office exceeding 10,000 in any year of assessment is however chargeable.

(ii) Section 36 exempts gains accruing on disposal of a dwelling house (with a maximum land area of up to one acre or such larger area as the Revenue Service may determine) which has been the individual's only or main residence throughout the period of ownership up to the time of disposal or up to the last twelve months before the date of disposal. So far as it is necessary for the purposes of this Section to determine which of two or more residences is an individual's main residence for any period:

- The individual may conclude that question by notice in writing to the Revenue Service given within two years from the beginning of that period. This can be varied by a further notice in writing to the Revenue Service as respects any period beginning not earlier than two years before the giving of the further notice, and

- The question shall be concluded by the determination of the Revenue Service. The individual may appeal to the Appeal Commissioners against that determination within thirty days of service of the notice by the Revenue Service.

(iii) A gain accruing on disposal of tangible and movable assets shall not be chargeable gain if the total value of the consideration does not exceed ₦1,000 in a year of assessment (Section 37(1). If the proceeds of disposal exceed ₦1,000 in an assessment year, the amount of CGT chargeable on the gain shall not exceed half the difference between the amount of that proceed and ₦1,000.

(iv) A motor vehicle for carriage of passengers is an exempt asset for CGT purposes unless it is of a type not commonly used as private vehicle and is unsuitable to be so used (Section38).

(v) Section 39 exempts assets acquired by way of gift and disposed of in a similar manner.

(vi) Section 40 - exempts capital gains accruing to a diplomatic body.

(vii) Double taxation relief is applicable to CGT as it is applicable to income tax under PITA and company's income tax under CITA with the substitution of the words capital gains for income and profits and CGT for income tax.

(viii) The following exemptions have been included with effect from 1993:

- Gains arising from takeover, absorption or merger provided that no cash payment is made in respect of the shares disposed/acquired (Section32A).

- Gains arising in respect of disposals of securities in a Unit Trust provided the proceeds are re-invested (Section32B) Stocks and shares of every description are exempted with effect from 1 January,1998.

13.6.1 Exemptions from capital gains tax based on the provisions of Finance Act, 2019 and Finance Act, 2020

With implementation of Finance Act, 2019, compensation for loss of office below N10 million is now exempted from capital gains tax.

Also, Finance Act, 2020 states that compensation for loss of office up to N10m should be exempted from capital gains tax and tax due on excess above N10m is to be deducted by the payer and remitted within the time specified under the Pay As You Earn (PAYE) Regulations.

13.7 Disposal and acquisition of assets

Meaning of 'Disposal'

Except as specifically exempted by the Act, there is a disposal of assets by a person where any capital sum is derived from a sale, lease, transfer, assignment, compulsory acquisition or any other disposition of assets, notwithstanding that no asset is acquired by the person paying the capital sum, and in particular:

(a) Where any capital sum is derived by way of compensation for any loss of office or employment;

(b) Where any capital sum is received under a policy of insurance and the risk of any kind of damage or inquiry to, or the loss, or depreciation of, assets;

(c) Where any capital sum is received in return for forfeiture or surrenders of rights or from refraining from exercising rights;

(d) Where any capital sum is received as consideration for use or exploitation of any asset; and

(e) Without prejudice to paragraph (a) above where any capital sum is received in connection with or arises by virtue of any trade, business, profession or vocation (Section 6(1). It is also stated in the Act that disposal includes reference to part disposal.

When an acquisition/disposal is effective

Acquisition/disposal takes effect on the date of the contract to acquire/ dispose of the asset or on a date at which there is an enforceable right to acquire or a binding duty to dispose of the asset or any right or interest therein, and in particular:

(a) Where any contract is to be performed subject to any condition, the date of acquisition/disposal shall be the date when the condition is satisfied, but where a consideration of such contract does not depend solely or mainly on the value of the asset at the time the condition is satisfied, the acquisition/disposal shall be treated as if the contract had never been conditional, in which case the effective date shall be the date of the contract.

(b) Where an option is conferred by virtue of any contract, the date of the acquisition or disposal of asset shall be the date when the option is exercised (Section11).

Hire purchase transactions

Where a fixed asset is purchased under hire-purchase, the cost for tax purposes is the cash price of the asset. The hire-purchase charges which represent the interest charges are allowable deductions under Section 20 of CITA in arriving at the assessable profits.

Thus, for capital gains tax purposes, if all the instalments have been paid before the date of disposal, it is the full cash price that is taken as the cost for Capital Gains Tax purposes. If the instalments have not been fully paid, the cost of the asset at the time of disposal will be the cash price portion of the instalments paid to the date of disposal.

Illustration 13.1

Union Company Ltd. purchased a chargeable asset on hire-purchase.
The deposit paid for the purchase was N250,000. The balance of the purchase price was to be paid in thirty-six monthly instalments of ₦25,000. The cash price of the asset is₦790,000.

Required:

Calculate the capital gains tax due assuming the assets were sold as follows:

(a) For ₦1.25million after payment of twenty-four instalments.

(b) For ₦1.3 million after full payment of all the instalments.

Suggested solution to 13.1

(a)	Disposal after 24 instalments paid	₦'000	₦'000	₦'000
	Sales price			1,250
	Less: Cost of the asset:			
	Deposit		250	
	Instalments paid totaled (24x₦25,000)	600		
	Less: interest element (24x₦10,000)	240		
			360	
				(10)
	Capital Gains			640
	Capital Gains Tax at10% thereof			64
(b)	Disposal after full payment of all instalments			
	Sales Price			1,300
	Less: Cost:			
	Deposit		250	
	Instalments paid (36x₦25,000)	900		
	Less interest element (36x₦10,000)	360		
			540	
				790
	Capital Gains			510
	Capital Gains Tax at10% thereof			51
	Calculation of interest element of each instalment			
	Deposit			250

Total payable by instalments(36x 25)	900	
Total hire-purchase price		1,150
Less: the cash price	790	
Total interest element	360	
Total number of instalments (360 ÷ 36)		
Interest element of each instalment	10	

For simplicity, the interest element has been apportioned on the 'straight- line' basis.

Bargains comprising two or more transactions
Section 20 CGTA provides:

Where a single bargain comprises two or more transactions whereby assets are disposed of, those transactions shall be treated for the purposes of computing capital gains as a single disposal.

Where separate considerations are agreed or purported to be agreed for any two or more transactions comprised in one bargain (whether transactions whereby assets are disposed of or not) those considerations shall be treated as altogether constituting an entire consideration for the transactions and shall be apportion able between them accordingly.

Where any apportionment under this Section shall result in lesser consideration than that agreed (or purported to be agreed) in the bargain being attributable to the disposal of the assets, the separate considerations agreed (or purported to be agreed) in respect of those assets shall be deemed to be the consideration for which those assets are disposed of.

Part disposal

Where there is a part disposal, the cost of that part of asset disposed and that of the undisposed part shall be apportioned. The cost to be apportioned to the part disposed shall be in the proportion that the consideration for the disposal bears to the total value of the whole asset on the date of disposal. The value of the whole asset on that date is the consideration received in respect of the part disposed plus the market value of the part of the asset which remains undisposed (Section 17).

Thus if 'A' is the consideration received in respect of that part disposed of, and 'B' is the market value of the part which remains undisposed, while 'C' is the cost of the whole asset, then the apportionment will be based on the formula

$$\frac{A}{A + B} \times C$$

which shall be applied in computing the cost and/or all other sums allowable as a deduction in computing the amount of the gain accruing on the disposal, the remainder being attributable to the property which remains undisposed of.

Connected persons

In tax practice, certain persons are treated as being so closely involved with each other that they have to be viewed as the same person or that transactions between them need to be treated differently from those 'at arm's length'. These persons are referred to as 'connected persons'.
Transactions between such persons may be regarded as artificial or fictitious for the

purpose of determining the tax liability arising therefrom. This implies that the Revenue can make whatever adjustments as it considers necessary to counteract the reduction of liability to tax that could otherwise result from such transactions.

Transactions between connected persons

Where a person acquires an asset and the person making the disposal is connected with him, the person acquiring the asset and the person making the disposal shall be treated as parties to a transaction made otherwise than by way of a bargain at arm's length (Section 23(1 & 2).

The consideration shall be disregarded if less than the market value, and the consideration shall be deemed to be the market value.

Connected persons (Section24)

(a) An individual is connected with his/her spouse and with his/her relatives and their spouses;

(b) A trustee of a settlement is connected with the settlor of that settlement, and with any person connected with the settlor;

(c) A partner is connected with the person with whom he is in partnership and with the spouse or relative of that person;

(d) A company is connected with another company if–

- (i) The same person controls both, or
- (ii) One is controlled by a person who has control of the other in conjunction with persons connected with him, or
- (iii) A person controls one company and persons connected with him control the other or
- (iv) The same group of persons controls both, or
- (v) The companies are controlled by separate group which can be regarded as the same by interchanging connected persons.

(e) A company is connected with another person who (either alone or with persons connected with him) has control of it; and

(f) Persons acting to secure or exercise control of a company are treated in relation to that company as connected with each other and with any other person acting on the direction of any of them to secure or exercise such control. 'Relative'is also defined in the Act as meaning, brother, sister, ancestral or lineal descendant.

Consideration

Consideration for asset acquired/disposed of shall be deemed to be equal to the market value of the asset where any person acquires the asset:

(a) Otherwise than by way of a bargain made at arm's length;

(b) Wholly or partly for a consideration that cannot be valued or in connection with his own or another's loss of office or employment or diminution of emolument, or otherwise in consideration for or recognition of services or past services;

(c) As trustee for creditors of the person making the disposal (Section 7(1)).Where a person donates an asset acquired by him by way of a gift (not being an acquisition on a devolution on death) or otherwise, the person receiving the donation shall, for all purposes of the Act, so far as it relates to the interest taken by him, be deemed to have acquired the asset:

  (i) In a case where the amount of the consideration for which the asset was last disposed of by way of a bargain made at arm's length is ascertainable, for a consideration equal to that amount; and

  (ii) In any other case, for a consideration equal to the market value of the asset on the date of that disposal; and in this subsection "gift" does not include a donation mortis causa (Section 7(2)). The conveyance or transfer by way of security of an asset (including a retransfer on redemption of the security),shall not be treated for the purposes of the Act as involving any acquisition or disposal of the asset (Section 7(4)).

Where a person entitled to an asset by way of security or to the benefit of a charge or encumbrance on an asset deals with the asset for the purpose of enforcing or giving effect to the security, charge or encumbrance his dealings with it shall be treated for the purposes of the Act as if they were done through him as nominee of the person entitled to it subject to the security, charge or encumbrance; and this subsection shall apply to the dealings of any person appointed to enforce or give effect to the security, charge or encumbrance as receiver and manager or judicial factor as it applies to the dealings of the person entitled as aforesaid (Section 7(5).

An asset shall be treated as having been acquired free of any interest or right by way of security subsisting at the time of any acquisition of it, and as being disposed of free of any such interest or right subsisting at the time of the disposal; and where an asset is acquired subject to any such interest or right the full amount of the liability thereby assumed by the person acquiring the asset shall form part of the consideration for the acquisition and disposal in addition to any other consideration (Section 7(6)).

Where an asset is acquired by a creditor in satisfaction of his debt or part thereof, the asset shall not be treated as disposed of by the debtor or acquired by the creditor for a consideration greater than its market value at the time of the creditor's acquisition of it, and if a chargeable gain accrues to the creditor on a disposal by him of the asset the amount of the chargeable gain (where necessary) shall be reduced such that it will not exceed the chargeable gain which would have accrued if he had acquired the property for a consideration equal to the amount of the debt or that part thereof (Section7(7)).

Any amount that can be treated as income or profits for the purposes of the Income

Taxes Acts shall be excluded from the consideration for a disposal of assets for capital gains tax computation (Section13)).

Consideration payable by instalments
When the consideration is payable by instalments over a period exceeding 18 months, the chargeable gain accruing on the disposal shall be regarded as accruing in proportionate parts in the year of assessment in which the disposal is made and in each of the subsequent years of assessment up to the assessment year in which the last instalment is payable in the proportion of the amount of the instalments payable in each of the years. Such chargeable gain shall be deemed to accrue on the last day of each of the year of assessments in which the instalments are received (Section 18)). No allowance is given for possible bad debts at the time of computing the capital gains tax payable. However, if any part of the consideration already brought into the computation is subsequently shown to the satisfaction of the Revenue Service as irrecoverable, such adjustment, whether by way of discharge, or repayment of tax or otherwise, shall be made as is required inconsequence (Section 18(5)). Death (Section 8) On the death of an individual, any asset of which he was competent to dispose of shall for the purposes of the Act be deemed to be disposed of by him at the date of his death and acquired by the personal representatives or other person on whom the assets devolve for a consideration equal to:

(a) The amount of the consideration for which the asset was last disposed of by way of a bargain made at arm's length if ascertainable, or

(b) In any other case, the market value of the asset at that date; (subsection1).

The gains which accrue in consequence of subsection (1) of this Section shall not be chargeable to capital gains tax under the Act (subsection 2)

The personal representatives shall be treated as having the deceased's residence and domicile at the date of death (subsection 3).

On a person acquiring any asset as legatee:

(i) No chargeable gain shall accrue to the personal representatives; and

(ii) The legatee shall be treated as if the personal representatives' acquisition of the asset had been his acquisition of it,(subsection4).

In this section:
"Legatee" includes any person acquiring an asset under a testamentary disposition or on an intestacy or partial intestacy whether he takes beneficially or as trustee, and a donation mortis causa shall be treated as a testamentary disposition and not as a gift;

"Personal representatives" means

(a) The executor, original or by representation, or administrator for the time being of a deceased person under any law in force in Nigeria;

(b) Persons having in relation to the deceased under the law of another country any functions corresponding to the functions for administration purposes under any law in force in Nigeria or personal representatives as defined under paragraph (a) of this subsection, and references to personal representatives as such shall be construed as references to the personal representatives in their capacity as having such functions as aforesaid, (subsection7).

Assets lost or destroyed (Section 19)
If a capital sum is received by way of compensation for the loss or destruction of an asset whether under a policy of insurance or not, a relief is available to the owner, if the amount is applied within three years of receipt in acquiring a replacement of the asset lost or destroyed.

The owner can claim:

(a) As if the consideration for the disposal of the old asset were (if otherwise of a greater amount) of such amount as would secure that neither a loss nor a gain accrued to him on the disposal; and

(b) As if the consideration for the acquisition of the new asset were reduced by the excess of the amount of the capital sum received together with any residual value or scrap value, over the amount of the consideration which he is treated as receiving under paragraph (a) above.

If part of what would have been the chargeable gain (but for this provision) is what is reinvested, then the relief available will be proportionally reduced.

13.7.1 Roll-over relief (Section 32 CGT Act)

If the consideration received on disposal of an old asset used only for the purposes of a trade is applied in acquiring a new asset in replacement to be used for the purposes of the trade and the old asset and the new asset are within one, and the same one, of the classes of assets listed in the Act, the person carrying on the trade shall, on making a claim as respects the consideration which has been so applied, be treated for CGT purposes as if the:

(a) Consideration for the disposal of the old asset were (if otherwise of a greater amount or value) of such amount as would secure that on the disposal neither a loss nor a gain accrues to him, and

(b) Value of the consideration for the acquisition of the new asset were reduced by the excess of the value of the actual consideration for the disposal of the old asset over the amount of the consideration which he is treated as receiving under paragraph (a)above.

The foregoing will not have any effect on the parties to the transactions involving the old or new assets other than the claimant. This is to say that the purchaser of the old asset will still be treated as acquiring that asset at the price which he has paid for it while the seller of the new asset will be treated as having sold the new asset at the price he received for it.

Illustration 13.2

Mr. Niger sold his factory buildings which he acquired ten years ago for ₦500,000. The cost of acquisition at that time was ₦100,000. He acquired a new factory for ₦750,000 to enable him carry on his business.

Suggested solution to illustration 13.2

For CGT purposes, and upon Mr. Niger making a claim, he will be treated,

(a) as if neither a loss nor a gain accrues to him on the disposal, that is the proceeds of disposal will be taken to be equal to the cost which is ₦100,000 and therefore no capital gains tax is payable; and

(b) as if the cost of acquisition of the new asset (₦750,000) were reduced by the excess of the actual proceeds of disposal of the old asset (₦500,000) over the amount of the proceeds which he is treated as receiving under paragragh (a) (₦100,000), that is,₦400,000 which would otherwise be the capital gain on the disposal of the old asset, will be deducted from the cost of the new asset.

Thus, the cost of the new asset for capital allowances and CGT purposes will be ₦350,000 (₦750,000 –₦400,000). This is what is referred to as roll-over relief in CGT practice. The liability to CGT on gains which have been fully reinvested in the same asset used for the same trade being deferred until the replacement asset is finally disposed.

Note that where the insurance compensation money for the loss or destruction of a capital asset is applied within three years of receipt in acquiring a replacement asset, the above shall also be applicable if the owner so claims (Section 19). Continuing with the example of Mr. Niger from above, the purchaser of Mr. Niger's factory will not be affected by this arrangement neither will the seller of the new factory as they will record their transactions as having purchased and sold the factories for ₦500,000 and ₦750,000 respectively.

If only part of the proceeds of disposal is reinvested and the amount reinvested is greater than the cost of the old asset, the owner, if he so claims, shall be treated:

(a) as if the amount of the gains so accruing were reduced to the amount of the said part with a proportionate reduction in the amount of the chargeable gain, and

(b) as if the amount of the consideration for the acquisition of the new asset were reduced by the amount by which the gain is reduced under paragragh (a)above.

In other words, if the proceeds are not fully reinvested, the amount of relief available will be the proportion which the gain reinvested bears to the total gain accruing on the disposal.

For the foregoing to be applicable, the acquisition of the new asset should be completed within the period of twelve months before and twelve months after the date of the disposal of the old asset or at such earlier time as the Revenue Service may by notice in writing allow.

Where an unconditional contract for the acquisition has been entered into, this

Section may be applied on a provisional basis without waiting to ascertain whether the new asset is acquired in pursuance of that contract. When the fact is ascertained, all necessary adjustments shall be made by making additional assessments or by repayment or discharge of tax, and shall be made notwithstanding any limitation in the Act on the time within which assessments may be made. The assets to which this Section applies are classified as follows:

Class 1 assets

A – Land and building and any permanent or semi-permanent structure in the nature of a building, occupied (as well as used) only for the purposes of trade.

B – Fixed plant or machinery

Class 2 assets – Ships

Class 3 assets – Aircraft

Class 4 assets – Goodwill

If over the period of ownership, or any substantial part of the period of ownership, a part of a building or structure is partly used for the purposes of a trade, this Section shall apply as if the part so used is a separate asset. It will be subject to any necessary apportionment for an acquisition or disposal (Section 32.7).

This section shall apply in relation to a person who, either successively or at the same time, carries on two trades which are in different localities, but which are concerned with goods or services of the same kind, as if in relation to old asset used for the purposes of the one trade and new assets used for the purposes of the other trade, the two trades were the same (Section 32.9).

This section shall apply with the necessary modifications in relation to a business, profession, vocation or employment as it applied in relation to a trade.

The expressions “trade,” “business”, “profession”, “vocation”, and “employment” have the same meanings as in the Income Tax Acts, but not so as to apply the provisions of those Acts as to the circumstances in which, on a change in the persons carrying on a trade, a trade is to be regarded as discontinued, or as set up and commenced (Section 32.10).

13.8 Delayed remittances relief

Section 42(1) - A person charged or chargeable for any year of assessment in respect of chargeable gains accruing to him from the disposal of assets situated outside Nigeria may claim that the following provisions of this section shall apply on showing that:

(a) He was unable to transfer those gains to Nigeria; and

(b) That inability was due to the laws of the country where the income arose, or to the executive action of its government, or to the impossibility of obtaining foreign currency in that territory; and

(c) The inability was not due to any want of reasonable endeavours on his part. Section 42(2) - If he so claims, then for the purposes of capital gains tax:

(i) There shall be deducted from the amounts on which he is assessed to capital gains tax for the year in which the chargeable gain accrued to the claimant the amount as respects which the conditions in paragraphs (a), (b) and (c) of subsection (1) of this section are satisfied, so far as applicable, but

(ii) The amount so deducted shall be assessed to capital gains tax on the claimant (or his personal representatives) as if it were an amount of chargeable gains accruing in the year of assessment in which the said conditions cease to be satisfied:

Section 42(3) - No claim under this section shall be made in respect of any chargeable gain more than six years after the end of the year of assessment in which that gain accrues.

Section 42(4) - The personal representatives of a deceased person may make any claim which he might have made under this section if he had not died.

13.9 Offences and penalties

There is no special provisions in Capital Gains Tax Act relating to offences and penalties. The CGT Act however provide that Part XIII of the Companies Income Tax Act (CITA) CAP C21 LFN 2004, on offences is applicable to CGT.

13.10 Other matters

13.10.1 Artificial or fictitious transactions

Where the Revenue Service is of the opinion that any disposition is an artificial or fictitious transaction or where any transaction which reduces or would reduce the amount of any capital gains tax is artificial or fictitious, the Revenue Service shall disregard such disposition and may direct that such adjustments shall be made with respect to the liability of any person for the payment of capital gains tax as it considers appropriate so as to counteract the reduction of liability to capital gains tax effected or reduction which would otherwise be effected, by the transaction and any person concerned with such transaction shall be assessable accordingly (Section 21(1)).

Any person in respect of whom any direction is made under this section shall have a right of appeal in like manner as though for the purposes of the Act, such direction were an assessment to CGT (Section 21(2)).

"Disposition" includes any trust, grant, covenant, agreement or arrangement: (Section 21(3)(a)).

Transactions between connected persons shall be deemed to be artificial or fictitious, if in the opinion of the Revenue Service those transactions have not been made on terms which might fairly have been expected to have been made by persons engaged in the same or similar activities dealing with one another at arm's length (Section 21(3)(b)).

In relation to any direction made under this section, the provision of the Act as to appeals against an assessment shall have effects as if such direction were an assessment (Section 21(3)(c)).

13.10.2 Location of assets

For the purposes of the Act:

(i) The situation of rights or interests (otherwise than by way of security) in or over immovable property is that of the immovable property;

(ii) Subject to the following provisions of this subsection, the situation of rights or interests (otherwise than by way of security) in or over tangible movable property is that of the tangible movable property;

(iii) Subject to the following provisions of this Section, a debt, secured or unsecured, is situated in Nigeria if and only if the creditor is resident in Nigeria;

(iv) Shares or securities issued by any governmental, municipal, local or native authority, or by any body created by such an authority are situated in the country of that authority or place where the authority is situated;

(v) Subject to paragraph (d) of this section, registered shares or securities are situated where they are registered and, if registered in more than one register, where the principal register is situated;

(vi) A ship or aircraft is situated in Nigeria if and only if the owner is then resident in Nigeria, and an interest or right in or over a ship or aircraft is situated in Nigeria if and only if the person entitled to the interest or right is resident in Nigeria;

(vii) The situation of goodwill of a trade, business or professional asset is at the place where the trade, business or profession is carried on;

(viii) Patents, trade-marks and designs are situated where they are registered, and if registered in more than one register, where each register is situated, and copyright, franchises, rights and licences to use any copyright material, patent, trade-mark or design are situated in Nigeria if they, or any rights derived from them, are exercisable in Nigeria; and

(ix) A judgement debt is situated where the judgement is recorded (Section25).

13.10.3 Assets located outside Nigeria (Section4)

Capital gains tax is payable on the gains arising on the disposal of assets situated outside Nigeria, so long as the proceeds are received in, or brought into Nigeria.

The tax is due:

(i) Where the disposal is by an individual who:

- Is visiting Nigeria temporarily with no intent to establish residence, and
- spends more than 183 days out of a 12 month period, in Nigeria.

(ii) Where the disposal is by a Non-Nigerian Company, managed and controlled from outside Nigeria.

13.10.4 Other provisions

(i) Section 22(1) – Market value in relation to any assets means the prices which those assets might reasonably be expected to fetch on a sale in the open market.

(ii) Section 22(2) – In estimating the market value, no reduction shall be made in the estimate on the account that the estimate is based on the assumption that the whole of the assets is to be placed on the market at one and the same time.

(iii) Section 22(3) – In re-estimating the market value of any assets acquired, if the market value exceeds the consideration actually paid by the acquirer, the assets shall be deemed to have been acquired for the amount actually paid by the acquirer.

13.10.5 Anti-avoidance provision – section 44(3)

Without prejudice to the provisions of the Stamp Duties Act, the Minister with responsibility for matters relating to stamp duties shall demand tax clearance certificates when checking documents on sale by any company of landed property and other assets before accepting such documents for stamping. Another anti-avoidance provision has been introduced with effect from January 1, 1993. It makes the production of evidence of tax payment a condition for effecting change of ownership of property, including shares and stocks (Section 44A).

13.11 Chapter review

This chapter deals with the taxation of gains that cannot be regarded as income. Such gains are classified as capital gains, as they cannot be included in income for income tax purposes.

This chapter shows that capital gains tax will be due on chargeable capital gains arising on disposal of capital assets to the extent that such are not specifically exempted by the

Act. The current rate of the capital gains tax is 10%.Capital loss on disposal of an asset cannot be relieved against the capital gains on another asset even if the two assets are in the same class.

Readers must have also learnt the amendments to Capital Gains Tax Act occasioned by Finance Act, 2019 and Finance Act, 2020.

13.12 Worked examples

13.12.1 Open-ended questions

(1) Best Manufacturing (Nig.) Limited is engaged in the production of building materials in Ota, Ogun State. Due to sudden power surge at night, one of the two factories got burnt before fire fighters arrived the scene.

The factories were comprehensively insured with MACON Insurance Company Plc. The management decided to move the factory from Ota to Lagos State. Concerted efforts were made to acquire land for a new factory in Ejigbo and the factory in Ota that was not burnt which cost ₦1,800,000 six years earlier, was sold for ₦4,200,000 inMarch 2007. The amount formed part of the cost of construction of the new factory at Ejigbo which was completed in November 2007, at a cost of ₦5,600,000

In 2008, for the Ota factory costing ₦3,700,000, the insurance company paid ₦5,900,000 to Best Manufacturing (Nig.) Ltd. Out of the compensation received, ₦4,600,000 was spent on the construction of the new factory in Ejigbo whilst the balance was put in a fixed deposit account to yield interest.

Best Manufacturing (Nig.) Ltd has just appointed you as the company's Tax Consultants.

Required:
Advise the management on:

(a) The capital gains (if any) arising from the events

(b) The capital gains tax payable

(c) How the company can reduce the capital gains tax payable.

(2) Janid Investment Limited sold its two buildings situated on Lagos- Badagry Expressway, Amuwo, Lagos and another in Ibadan.

The building in Lagos was compulsorily acquired by the State Government in June 2008 in the course of the dualisation of the road. A compensation of ₦25,000,000 was paid for the building which originally cost the company ₦2,500,000. Fearing that the same predicament might befall the Ibadan building, the company quickly sold the building for ₦15,500,000 on 6 July 2008. Its original costwas₦850,000.Sales expenses amounted to₦3,250,000.

The company normally makes accounts to December 31, each year and the properties which were sold and purchased were reflected in the accounts to December 31, 2008. The company decided to move to Ogun State where between September and November 2008, it. Acquired a new site and erected another business building at a cost of ₦20,500,000.

Required:

(a) Compute the capital gains tax liability for the relevant year of assessment.

(b) State one other alternative open to Janid Investments Limited in discharging its capital gains tax liability and the time limit for exercising the option.

(3) In April 2004, Dr. Mensah acquired a house at a cost of ₦60million. Other acquisition expenses incurred were ₦100,000 for legal fees and ₦200,000 valuation fee. On November 30, 2004, a duplex was constructed in the excess space at a cost of ₦12million.

On June 1 2005, the duplex was sold to Uncle Jimmy for ₦16 million. The actual market value was ₦20 million and the value of remaining property was ₦68 million. On 1 January 2006, Dr. Mensah sold the remaining property for ₦72 million after paying for the following expenses:

	₦
(a) Improvements prior to sale	1,000,000
(b) Estate Agency fees	400,000
(c) Legal fees	120,000
(d) Advertising	240,000
	1,760,000

Required;
Compute the capital gains tax for the relevant years of assessment.

(4) Meltdown Construction Limited purchased a bulldozer on hire purchase on 1 February 2007 and paid a sum of ₦28,500,000 as a deposit on the purchase price. The cash price of the bulldozer at the time of purchase was₦45,000,000, but Meltdown Construction Limited was allowed to pay the balance in twenty monthly instalments of ₦1,000,000 each with effect from March 1, 2007.

Required:
Calculate the capital gains tax for the relevant year of assessment, assuming that the bulldozer was sold for:

(i) ₦48,400,000 after the payment of instalments on December 3, 2007.

(ii) ₦49,600,000 after the payment of instalment on September 5, 2008.

(5) White Cleaners Ltd. is involved in dry cleaning business. The company acquired a building for the business within Shonibare Estate, Maryland, in the year 2011 at a cost of ₦25,000,000. It also acquired dry cleaning equipment and a generating set at the costs of ₦5,000,000 and ₦3,500,000 respectively.

The wrong location of the company coupled with the poor performance of equipment some of which were refurbished but wrongly believed to be new resulted in low patronage. The company resolved to make a new start in the year 2013 by selling off everything to use the proceeds to augment the acquisition of new ones.

The building was sold for ₦30,000,000 while the equipment and generating set were sold for ₦3,500,000 and ₦4,300,000, respectively.

A new building was acquired on Victoria Island for the same business at ₦65,000,000 while the equipment and new generating sets were acquired for ₦7,500,000 and ₦3,000,000 respectively.

You are required to compute:

(a) The capital gains

(b) The roll-over relief available (if any)

(c) Capital gains tax payable

(d) The costs on which capital allowances will be granted to the company based on the newly acquired assets.

13.12.2 Suggested solutions to open-ended questions

1. **XYZ & CO. (CHARTERED ACCOUNTANTS)**
2. **2, AYODEJI STREET, IKEJA – LAGOS STATE**

O/RY/R November 15, 2009

The Managing Director
Best Manufacturing (Nig.) Ltd.
Ejigbo
Lagos State

Dear Sir,

RE: ADVICE ON TAX IMPLICATIONS OF DISPOSAL OF A PROPERTY/INSURANCE CLAIMS RECEIVED ON DESTROYED PROPERTY

We are in receipt of your letter dated November 5, 2009, appointing us as your company's tax consultants and specifically requesting for our advice on the following under-listed areas:

Capital gains (if any) arising from the transactions;

The capital gains tax payable; and

Suggestions on ways of reducing the capital gains tax.

After thorough examination of the information provided in your letter under reference, we state as follows:

(a) In respect of item (a) Appendix I shows the capital gains for assessment years 2007 and 2008; and

(b) For the assessment year 2007, your company is not liable to capital gains tax for the fact stated under Appendix I, while for assessment year 2008, the capital gains tax is N130,000, as shown under Appendix II.

(c) In our opinion, for your company to have a reduced liability on capital gains tax, the full proceeds of N5,900,000 should be applied to Ejigbo factories, thus having a full benefit of roll over relief in 2008 assessment year.

We have based all our computations on the following provisions of the tax laws;

(i) Assets lost or destroyed and replacement of business assets;

(ii) Roll over relief on re-investment of disposal proceeds of similar assets; and

(iii) The mandatory period of 12 months of disposal of old Assets within which re-investment occurred. As shown in our computations, your company was liable to capital gains tax in 2008, because the amount reinvested was less than the claim proceeds.

Should you require any further clarifications or explanation, we would be most obliged to do so.

Once again, we use this opportunity to thank you for your understanding and cooperation and for considering us for this assignment.

Yours faithfully,
For: XYZ & Co. (Chartered Accountants)

PETER JAMES
MANAGING PARTNER

(a) **APPENDIX I**
BEST MANUFACTURING NIG. LTD

Capital Gains for 2007 year of assessment		₦'000
Disposal of OTA warehouse		
Sales proceeds		4,200
Less: Cost of acquisition		(1,800)
Capital gains		**2,400**
Deduct roll-over relief:		
The lower of:		
Amount reinvested in Ejigbo	5,600	
Actual sales proceeds	4,200	
Less : Cost of acquisition	1,800	
Capital gains rolled over		(2,400)
Net capital gains		₦

ii.

Reason: The amount reinvested is greater than the sale proceeds; therefore, full roll-over relief will be claimed.

(b) **Capital gains for 2008 year of assessment**

	₦'000
Disposal of OTA factory	
Claim from MACON	5,900
Less: Cost of acquisition	(3,700)
Capital gains **2,200**	
Deduct roll-over relief:	
The lower of:	
Amount re-invested	4,600
Claim/sales proceeds	5,900
Less : Cost of acquisition	3,700
Capital gains rolled over	(900)
Net capital gains	1,300

Total Capital Gains made on the project	
2007 Year of assessment – Disposal of warehouse	2,400
2008 Year of assessment – Disposal of factory	2,200

APPENDIX II

Capital gains tax payable	₦'000
2007 Year of assessment	Nil
2008 Year of assessment (₦1,300,000x10%)	130

(c) **Ways to reduce the capital gains tax**

In order to reduce the capital gains tax, the full proceeds of ₦5,900,000 should be applied to Ejigbo factories so that the company can benefit from full roll-over relief in 2008 assessment year.

3. **Janid Investments Limited**

(a) Computation of capital gains tax liability

(b) For 2008 year of assessment

	Lagos building ₦	Ibadan building ₦
Compensation/sales proceeds	25,000,000	15,500,000
Deduct:- sales expenses	-	(3,250,000)
Net compensation/sales	25,000,000	12,250,000
Deduct:- acquisition costs	(2,500,000)	(850,000)
Capital gains	22,500,000	11,400,000
Capital gains tax (10%)	NIL 1,140,000	

The capital gains arising on the Lagos building is exempted from capital gains tax, because it relates to a compulsory acquisition of property by an authority that has the power to do so.

(c) The company can discharge its capital gains tax liability by claiming roll-over-relief from the disposal of the Ibadan building. full roll over relief will be granted if the whole of the consideration of N15,500,000 obtained from the sale of the Ibadan building is reinvested in the construction of the Ogun building.

The time limit within which the proceeds from the sale of the old asset must be reinvested in the new asset is a period beginning twelve months before and ending twelve months after the disposal of the old asset.

"Please note that the tax law did not specify the time limit for claiming roll-over relief."

4. **Dr. Mensah**

Computation of capital gains tax for 2005 and 2006 tax years

2005 – 01/01/05 to 31/12/2005

		₦	₦
Consideration received:			
(Market value of duplex)			20,000,000
Deduct: Cost of duplex			(12,000,000)
Capital gains			8,000,000
Capital gains tax @ 10%			800,000
2006-01/01/06 to 31/12/2006			
Consideration received			72,000,000
Deduct: incidental selling expenses:			
Estate agency fees	400,000		
Legal fees	120,000		
Advertising	240,000		(760,000)
Net proceeds			71,240,000
Deduct: Cost of acquisition			
Consideration paid incidental cost of acquisition:		60,000,000	
Legal fees		100,000	

Valuation fee	200,000	
Cost of improvements	1,000,000	
		(61,300,000)
Capital gains		9,940,000
Capital gains tax @10%		994,000

(4) (i)

Meltdown Construction Limited
Computations of capital gains tax
For 2007 year of assessment

	₦	₦	₦
Sales proceeds of bulldozer	48,400,000		
Cost of bulldozer			
Deposit paid	28,500,000		
Instalments paid (10 months @N1,000,000 each)	10,000,000		
Interest portion paid (W2)	(1,750,000)	8,250,000	(36,750,000)
Chargeable gains		11,650,000	
Capital gains tax thereon @10%	**1,165,0**00		

(ii)

Meltdown Construction Limited
Computations of capital gains tax
For 2008 year of assessment

	₦	₦	₦
Sales proceeds of bulldozer			49,600,000
Cost of bulldozer			
Deposit paid		28,500,000	
Instalments paid (19 months @ ₦1,000,000 each)	19,000,000		
Less interest portion paid (W3)	(3,325,000)		
		15,675,000	(44,175,000)
Chargeable gains			5,425,000
Capital gains tax thereon @ 10%			542,500

Working notes

(W1) **Calculation of hire purchase interest**

Hire purchase price;

¨	Deposit (1/2/2007)	28,500,000
¨	20 Installments payable (March 2007 to October 2008) @ N1,000,000 per month	20,000,000

	48,500,000
Cash price	45,000,000
Hire purchase interest for 20 months	3,500,000

(W2) **Calculation of hire purchase interest up to 1/12/2007**

Hire purchase interest payable ₦3,500,000

Hire purchase interest at the time of disposal – 3/12/2007 $\frac{N3,500,000}{20}$ x10 = ₦1,750,000

(W3) **Calculation of hire purchase interest up to 1/10/2008**

Hire purchase interest for 19 months at the time of disposal

(i.e.5/9/2008) = ₦175,000 x 19 months
₦3,325,000

5. **White Cleaners Ltd.**

Computation of capital gains for 2013 tax year –

	₦
Building	
Proceeds from disposal	30,000,000
Cost of acquisition	(25,000,000)
Capital gains	5,000,000
Equipment	
Proceeds from disposal	3,500,000
Cost of acquisition	(5,000,000)
Capital loss	(1,500,000)
Generating set	
Proceeds from disposal	4,300,000
Cost of acquisition	(3,500,000)
Capital gains	800,000
Total capital gains	5,800,000

Note:

Capital loss on disposal of any asset is not deductible from capital gains on disposal of any other asset, even if both are of the same type.

(b) **Computation of 'roll over relief'**

(i) Building

	₦
Proceeds from disposal	30,000,000
Cost of acquisition	(25,000,000)
Capital gains	5,000,000

Less rollover relief:

The lower of:	
Amount re-invested	65,000,000
Actual sales proceeds	30,000,000
Less: Cost of acquisition	25,000,000
Capital Gains roll-over	(5,000,000)
Balance liable to tax	NIL
Capital Gains Tax payable@10%	NIL

(ii) Equipment

	₦
Proceeds from disposal	3,500,000
Cost of equipment	(5,000,000)
Capital loss	(1,500,000)
Rollover relief	NIL
Capital gains tax @10%	NIL

Notes: Roll over reliefs

Rollover relief is applicable where the capital gains have been fully/ partially reinvested in replacement of assets for the purpose of the company's business.

(i) New building was acquired at ₦65,000,000, hence the ₦30million proceeds from the disposal of the old asset and the capital gains had been fully reinvested in the replacement assets – rollover relief is available.

(ii) On the equipment there was no rollover relief because of capital loss incurred.

(iii) On the generating set, there was no rollover relief because the new asset was purchased at a lower cost than the one replaced, therefore no part of the capital gains was reinvested.

(c) **Capital gains tax payable**

This is applicable only on generating set

	₦	₦
Proceeds from disposal	4,300,000	
Cost of old generating set	(3,500,000	800,000
Rollover relief:		
The lower of :		
Amount reinvested in the new set		3,000,000
Actual sales proceed	4,300,000	
Less: Cost of old generating set	3,500,000	
Capital Gains roll-over	NIL	
Balance liable to CGT	800,000	
Capital gains tax @10%		80,000

(d) The costs at which capital allowances are based for the newly acquired assets are:

		₦
Building - Cost of new building		65,000,000
Generating set - Cost of new generating set	3,000,000	
Equipment - Cost of new equipment	7,500,000	

Notes on claiming roll-over reliefs

(i) The asset disposed of must have generated capital gains

(ii) The new asset must cost more than the sales proceeds of the disposed asset.

(iii) The amount reinvested in the new asset must exceed the cost of the old asset, in other words, you cannot have a loss on disposal of an old relevant asset and hope to claim roll-over relief on the class of asset.

14

Taxation of digital economy

Contents

Taxation of digital economy

14.0 Purpose

After studying this chapter, readers should be able to:

(a) understand what digital economy means

(b) differentiate between digital economy and traditional economy

(c) appreciate the problems associated with taxing digital economy;

(d) understand the gaps between existing tax legislation in Nigeria and digital economy

(e) understand measures put in place by other countries to tackle the problem associated with taxing digital economy

(f) understand what could be done in Nigeria to block tax revenue leakages associated with digital economy

14.1 Introduction

Digital economy is the worldwide network of economic activities, commercial transactions and professional interactions that are enabled by information and communications technologies (ICT). Also, digital economy refers to an economy that is based on digital computing technologies, that is conducting business through markets based on the internet and the World Wide Web. The digital economy is also sometimes called the Internet Economy, New Economy, or Web Economy. Increasingly, the digital economy is intertwined with the traditional economy, making a clear delineation harder. The digital economy is increasingly becoming the economy itself. International borders are closing in and distance is no longer a barrier to sealing business deals.

The essential elements of the digital economy include:

- Digitalization and intensive use of information and communication technologies (ICT)
- Codification of knowledge
- Transformation of information into commodities
- New ways of organizing work and production

14.2 Taxation of digital economy in Nigeria

Taxation of digital transactions has become a herculean tax for tax authorities all over the world because digital transactions require little or no physical presence of the parties to which income accrues, in the jurisdiction of the consumer. It is usually challenging to determine whether tax on cross border transactions should be paid to the jurisdiction where value is created or consumed. Moreover, the general rule for taxing income of foreign enterprises in a given jurisdiction is by establishing that the entity is physically present or has a permanent establishment in such a country. Thus, profits derived from foreign jurisdictions might end up not being taxed in the jurisdiction of the consumer where money was parted with.

The Organisation of Economic Cooperation and Development (OECD) and the European Union (EU) have offered certain recommendations to address incidences of non-taxation of income arising from digital transactions. These include the introduction of a Digital Service Tax and the concept of a Virtual Permanent Establishment to help determine the incidence of permanent establishment for tax purposes.

Nigeria seems not to have made significant progress in the taxation of digital transactions although myriads of digitalized transactions are carried on in Nigeria daily. Although the Nigerian tax authorities are working towards ensuring digitalization of the tax collection process, it is unfortunate that this digitalization has not been extended to cover effective monitoring and collection of taxes from digital transactions.

14.2.1 Challenges of taxing digital economy in Nigeria

The rapid growth in information and communications technology (ICT) in Nigeria has brought with it boundless opportunities and changes in the way we do business. Today, a significant number of transactions in Nigeria (sale and purchase of goods and services) are consummated using mobile devices and online payment platforms. This is broadly referred to as electronic commerce (e-commerce).

The e-commerce story in Nigeria started during the early part of the 21st century and its development has steadily been on the rise. This has been re-echoed by the Central Bank of Nigeria's recent implementation of the cashless policy with one of its aims being to encourage more electronic-based transactions (payments for goods, services, transfers, etc.).

Whilst there are numerous benefits of e-commerce, the paradigm shift from a physical to an 'invisible' business framework comes with its challenges. One of these challenges is tracking transactions especially for the purposes of taxation.

The drive towards growing non-oil tax revenue (through fiscal optimization) and eliminating leakages are not mutually exclusive objectives. Thus, the process of diversifying the revenue base of the economy can only be further complemented by the choices the Federation makes to arrest revenue leakages from the digital economy.

The inability to adequately capture the quantum of attendant direct and indirect taxes payable on ecommerce transaction has left leakages in the tax system. Whilst this is by no means a problem created or condoned by Federal Inland Revenue Service (FIRS), there is little doubt that a strategic partnership with institutions which provide platforms to consummate such transactions would ensure that the objective of minimizing and reducing tax leakages especially from the digital economy is achieved at a faster pace.

In addition, the applicable rules for corporate taxation have failed to effectively capture the realities of a modern economy in our world of fast-paced digital transactions. There are also various profitable business models in digital services that derive income from countries without creating palpable physical presence.

Given that non-resident companies are taxed in Nigeria based on profits derived from Nigeria, the question as to whether a foreign company is liable to pay income tax in Nigeria is usually controversial. Section 13 of the Companies Income Tax Act (CITA) implies that a non-resident company must have physically performed activities in Nigeria before it can be concluded that such a company has income tax liability in Nigeria. Where a software company provides online data to a user in Nigeria for a fee and provides same to five million other users in Nigeria without being physically present in Nigeria in any form, it may be difficult to conclude that such a company is liable to Companies Income Tax in Nigeria, although the company may be seen to have derived income from Nigeria. More so, such transactions may elude the tax authorities' radar and the transactions will not be liable to Value Added Tax (VAT) if the transactions are not deemed to have taken place in Nigeria. The Federal Inland Revenue Service (FIRS) is, however, making efforts to ensure that income arising from e-commerce is subjected to Nigerian tax. These efforts seem to have yielded some results in the aspect of indirect taxes as opposed to direct tax. In recent times, the FIRS has made attempts to assess some foreign mobile application transport operators to income tax in Nigeria on the basis that the income for services they provide is derived from Nigeria. However, the absence of the required fixed base or physical operations in Nigeria under Section 13 of CITA has made it difficult for the FIRS to establish liability of such foreign companies to Nigerian tax. To ensure that companies, particularly digital companies, do not escape tax in Nigeria, the FIRS has often required Nigerian companies to withhold tax on all payments made to non-resident persons regardless of the non-establishment of the tax presence specified under Section 13 of CITA. This requirement has encountered resistance from taxpayers given that such non- resident persons may not be liable to Nigerian tax under Nigerian tax laws.

In some cases, the FIRS seems to have succeeded in ensuring that VAT is deducted and accounted for on cross border payments for transactions between foreign companies and Nigerian companies.

In the recent Federal High Court (FHC) judgment in the case between Vodacom Business Nigeria Limited v FIRS, the FHC ruled in favour of the FIRS and held that the Nigerian company was required to account for the VAT on such transactions regardless of the fact that the supplier/foreign company did not perform the services in Nigeria. According to the FHC, the services are not expressly exempt from VAT and are thus liable to Nigerian VAT.

14.3 Challenges of taxing digital economy – OECD and EU experience

It is important to note that the tax challenges arising from digital transactions are not peculiar to Nigeria.

In 2015, the OECD created a framework to tackle international tax avoidance arising from Base Erosion and Profit Shifting (BEPS). One of the Actions for the BEPS Project is to address the tax challenges of the digital economy. In March 2018, the OECD, in its interim report titled "Tax Challenges Arising from Digitalisation", described the typical characteristics of digitalized business models to include a wide digital footprint with limited or no physical presence, heavy reliance on intangible assets and high importance of data and user participation.

The EU succinctly explains the challenges arising from taxation in the digital economy as being a disconnect or mismatch between where value is created and where the taxes are paid. Due to the resultant revenue loss arising from these challenges, various jurisdictions and international associations have sought various means to tackle these challenges to ensure that the taxes are paid in the jurisdictions where income is derived.

14.4 Tackling the challenges associated with taxing digital economy: Other jurisdiction experience

OECD Recommended Proposals

The OECD's Interim Report on the implications of digitalization for taxation offers general guidance for Member Countries. The OECD is also committed to issuing an update and reaching a consensus-based solution by 2019 and 2020, respectively.

Following the Report, OECD members have agreed to undertake a coherent and concurrent review of the "nexus" and "profit allocation" rules. The "nexus" and "profit allocation" rules are fundamental concepts relating to the allocation of taxing rights between jurisdictions and the determination of the relevant share of multinational enterprises' profits that will be subject to taxation in a given jurisdiction. However, there are presently divergent views amongst the OECD Member Countries on the issue.

The Interim Report also discusses an interim measure in the form of an excise tax on the supply of certain e-services within a given jurisdiction that would apply to the gross consideration paid for the supply of such e-services. However, there is still no consensus by Member Countries on the need for this measure.

EU Recommended Proposals

In March 2018, the European Commission (the Commission) proposed new rules to ensure that digital business activities are taxed in a fair and growth-friendly manner in the EU. The Commission has made two legislative proposals.

One proposal recommends that member states apply an interim tax called Digital Service Tax (DST) which covers the main digital activities that currently escape tax in the EU. The DST is an interim tax which is to be levied at 3% on the gross revenue of businesses derived from the following service categories:

i. Online placement of advertisement;

ii. Sale of collected user data and other digital services; and

iii. Provision of digital platform to facilitate interactions between users.

The DST will be collected by the Member Countries where the users are located and will only apply to companies that have an annual total revenue of over £750 million and an annual total revenue of over £50 million from digital activities in the EU.The DST will apply as from 1 January 2020 until a final taxation model is adopted.

The other proposal aims to reform corporate tax rules by introducing the concept of a "taxable digital presence" or a Virtual Permanent Establishment (VPE) to ensure that profits are registered and taxed where businesses have significant interaction with users through digital channels. A VPE is designed to introduce a taxable nexus for digital businesses operating within the EU with little or no physical presence.

The Commission recommends that a digital platform will be deemed to have a "taxable digital presence" or a VPE in a member state if it fulfils one of the following criteria:

• It exceeds a threshold of £7 million in annual revenues from a member state;

• It has more than 100,000 users in a member state in a taxable year; or

• Over 3000 business contracts for digital services are created between the company and business users in a member state in a taxable year.

Ultimately, it is hoped that the concept of the VPE will secure a real link between where digital profits are made and where they are taxed.

United Kingdom (UK) Recommended Proposals

The UK's digital economy is estimated to have attracted over £28 billion in investments over the past 5 years which is reported to be more than any other European country. As a result, discussions around the taxation of the UK's digital economy are ongoing. In March 2018, the UK government published a Position Paper titled "Corporate Tax and the Digital Economy". In the Paper, the UK government opined that the current misalignment between where digital businesses are taxed and where they create value threatens to undermine the fairness, sustainability and the public acceptability of the corporate tax system. The UK government also holds the view that the preferred and most sustainable solution to this challenge is a reform of international corporate tax framework to reflect the value of user participation.

The Position Paper does not set out any conclusions but, however, states that there is need to consider interim measures such as revenue-based taxes on a multilateral basis. On this issue, the UK government intends to work closely with the EU and other international partners.

India Recommended Proposals

Following the OECD BEPS Action 1 which seeks to address the challenges that arise from the taxation of the digital economy, India enacted the Finance Act in 2016. This Act introduced an equalization levy which is a surtax of 6% on payments to foreign companies for online advertising services when such companies do not hold a permanent establishment in India. Furthermore, the lower house of the Indian Parliament passed a Finance Bill in March 2018. This Bill seeks to subject businesses that have a "significant economic presence" in India to Indian Tax notwithstanding that such businesses may not have any physical presence in India. The Bill defines significant economic presence to mean:

a. Transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate payments arising from such transaction or transactions during the previous year exceeds such amounts as may be prescribed; or

b. Systematic and continuous soliciting of business activities or engaging in interaction with such number of users, as may be prescribed, through digital means.

This concept of "significant economic presence" will become effective 1 April 2019 if the Finance Bill is signed into law.

14.5 Tackling the challenges associated with taxing digital economy in Nigeria

Digital economy is growing rapidly in Nigeria just as it is happening all over the world, therefore, there is need for urgent actions in Nigeria to block tax revenue leakages associated with existing gaps in taxing digital economy. Such actions include:

i. Review of the scope of "fixed base" under section 13 of CITA

Although Nigeria, just like India, is neither a member of the OECD nor the EU, it is important that the scope of "fixed base" under Section 13 of the CITA be expanded as is presently being proposed in India to ensure that the Nigerian digital economy is effectively captured for tax purposes. The introduction of a digital fixed base in Nigeria will certainly increase the tax base, thereby sharing the collective tax burden of taxpayers while ensuring an increase in government revenue.

ii. Adoption of creative approach through innovative tax legislation

It has become expedient for the Nigerian tax authorities to explore a more creative approach to ensure taxation of the digital economy. Nigeria will need to borrow a leaf from other nations who have taken bold steps to tackle the non- taxation of the digital economy to plug revenue leakages through innovative tax legislation rather than seeking to extend the interpretation of obsolete legislations that are not sufficient to bring cross border digital transactions into the tax net.Given the peculiarities and innovations of the digital economy, it will be most appropriate for the Nigerian Government to enact a legislation to adequately cater for the taxation of the digital economy rather than trying to make it fit into existing tax laws.

iii. Automation tax administration

Presently, FIRS has adopted the ITAS, an electronic filing platform as an indication of its seriousness to implement the aspirations lucidly expressed in the National Tax Policy (NTP) regarding the automation of the tax system. The NTP expects that "all processes starting from registration of taxpayers, filing of returns, audits and investigations, payment of taxes including correspondence with taxpayers will become automated. Where there are gaps in current tax laws or where the laws do not support the use of such systems, necessary amendments shall be made to ensure that the use of the systems are in line with the law".

The implication of this for the digital economy is two-fold. On one hand, full (or substantial automation) of the tax processes or system increases the degree of exposure of tax officers, administrators, taxpayers and other stakeholders in the use and mastery of those processes. On the other hand, it enhances the prospects of positioning the tax system and its electronic platforms for a robust and seamless interface with diverse payment platforms which can facilitate tracking of electronic transactions liable to tax in Nigeria.

Whilst it is tempting to assume the time is not ripe enough to mobilise resources to confront tax leakages from the digital economy (probably because there is evidence that FIRS is yet to maximize tax revenue from the registered taxpayers in the non-digital business front), the more reasonable course is to seek to deal with the tax leakages from the digital business simultaneously. The increasing number of business transactions that are consummated over digital platforms show that this is the way of the short to medium term future of business interactions.

iv. Data Handling

Another critical success factor in a digital economy is data handling. Elsewhere data is treated with something akin to reverence but Nigeria's data gathering and storage processes are still not fully integrated. This will require huge investments including for data protection as the recent ransomware "WannaCry" threat showed.

v. Strategic Partnership with digital economy service providers

The FIRS should form "a strategic partnership with institutions which provide platforms to consummate digital transactions in Nigeria. This would ensure that the objective of minimizing and reducing tax leakages especially from the digital economy is achieved at a faster pace.

vi. Ratification of multilateral Conventions

Ratification of multilateral conventions on tax related treaties to end profit shifting and tax evasion by multinational companies. The benefits are that the convention will swiftly modify existing bilateral tax treaties to implement tax treaty related matters in a cost efficient manner, instead of individual negotiations and amendment of the treaty. The treaty will address abuse of tax laws, raise government tax revenue, promote transparency and check illicit financial flows

vii. Capacity Development

There is need for capacity development for tax administrators so they can implement a seamless interface with the different payment systems available in Nigeria.

14.6 The provisions of the Finance Act, 2019 on digital and other services in relation to significant economic presence (SEP) of a foreign entity

The Finance Act, 2019 ("the Finance Act") introduced the concept of significant economic presence (SEP) to expand the scope of Nigerian tax on foreign companies deriving income from their activities in Nigeria which were hitherto not captured in the tax net. Consequently, the Companies Income Tax (Significant Economic Presence) Order, 2020 ("the Order") was issued by the Federal Government of Nigeria. This order was signed by the Honourable Minister of Finance (HMoF), Budget and National Planning.

The Order provides clarification on what constitute a SEP for foreign companies doing business, or providing services to customers, in Nigeria, in line with Section 13(2)(c) and (e) of CITA.

Determination of SEP for digital activities

The Order provides that a foreign company shall have a SEP in Nigeria in any accounting year, where it:

(a) Derives N25 million annual gross turnover or its equivalent in other currencies from any or combination of the following digital activities:

i. Streaming or downloading services of digital contents, including but not limited to movies, videos, music, applications, games and e-books to any person in Nigeria; or

ii. Transmission of data collected about Nigerian users which has been generated from such users' activities on a digital interface including website or mobile applications; or

iii. Provision of goods or services other than those under sub-paragraph 5 of the Order, directly or indirectly through a digital platform to Nigeria; or

iv. Provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers in Nigeria.

(b) Uses a Nigerian domain name (i.e., .ng) or registers a website address in Nigeria; or

(c) Has a purposeful and sustained interaction with persons in Nigeria by customizing its digital page or platform to target persons in Nigeria, including reflecting the prices of its products or services in Nigerian currency or providing options for billing or payment in Nigerian currency.

Determination of SEP for technical, professional, management and consultancy services

The Order provides that a foreign company providing technical, professional, management or consultancy services shall have a SEP in Nigeria in any accounting year where it earns any income, or receives any payment from a person resident in Nigeria, or a fixed base or agent of a foreign company in Nigeria.

Exemption from SEP

The Order exempts the activities of the following foreign companies from constituting a SEP in Nigeria:

a. Any foreign company under a multilateral agreement and consensus arrangement to address tax challenges arising from the digitalization of the economy who will be treated under such agreement or arrangement.

b. Any foreign company making any payment, where the payment, is made:

i. To its employee under a contract of employment; or

ii. For teaching in an educational institution or for teaching by an educational institution; or iii. By a foreign fixed base of a Nigerian company.

14.7 Chapter review

This chapter explains what digital economy means and differentiates it from traditional economy. The chapter also dwells on the challenges associated with taxation of digital economy in Nigeria and some other jurisdiction. Measures that could be adopted to block revenue leakages associated with gaps in taxing digital economy in Nigeria were also discussed in this chapter.

Readers must have learnt what constitute significant economic presence (SEP) for for foreign entity carrying on business of digital and other services in Nigeria according to the provision of Finance Act, 2019.

14.8 Worked examples

14.8.1 Open-ended question

1. (a) What are the challenges associated with taxing digital economy in Nigeria?

(b) What measures should be considered to block the revenue leakages associated with many digital transactions escaping tax in Nigeria?

2. Explain what would constitute significant economic presence for a foreign entity engaged in the following businesses in Nigeria as stipulated by the Companies Income Tax (Significant Economic Presence) Order, 2020:

(a) Digital services

(b) Technical, professional, management and consultancy services

14.8.2 Suggested solutions to open-ended questions

(1)

(a) The rapid growth in information and communications technology (ICT) in Nigeria has brought with it boundless opportunities and changes in the way we do business. Today, a significant number of transactions in Nigeria (sale and purchase of goods and services) are consummated using mobile devices and online payment platforms. This is broadly referred to as electronic commerce (e-commerce).

The e-commerce story in Nigeria started during the early part of the 21st century and its development has steadily been on the rise. This has been re-echoed by the Central Bank of Nigeria's recent implementation of the cashless policy with one of its aims being to encourage more electronic-based transactions (payments for goods, services, transfers, etc.).

Whilst there are numerous benefits of e-commerce, the paradigm shift from a physical to an 'invisible' business framework comes with its challenges. One of these challenges is tracking transactions especially for the purposes of taxation.

The drive towards growing non-oil tax revenue (through fiscal optimization) and eliminating leakages are not mutually exclusive objectives. Thus, the process of diversifying the revenue base of the economy can only be further complemented by the choices the Federation makes to arrest revenue leakages from the digital economy.

The inability to adequately capture the quantum of attendant direct and indirect taxes payable on ecommerce transaction has left leakages in the tax system. Whilst this is by no means a problem created or condoned by Federal Inland Revenue Service (FIRS), there is little doubt that a strategic partnership with institutions which provide platforms to consummate such transactions would ensure that the objective of minimizing and reducing tax leakages especially from the digital economy is achieved at a faster pace.

In addition, the applicable rules for corporate taxation have failed to effectively capture the realities of a modern economy in our world of fast-paced digital transactions. There are also various profitable business models in digital services that derive income from countries without creating palpable physical presence.

Given that non-resident companies are taxed in Nigeria based on profits derived from Nigeria, the question as to whether a foreign company is liable to pay income tax in Nigeria is usually controversial. Section 13 of the Companies Income Tax Act (CITA) implies that a non-resident company must have physically performed activities in Nigeria before it can be concluded that such a company has income tax liability in Nigeria. Where a software company provides online data to a user in Nigeria for a fee and provides same to five million other users in Nigeria without being physically present in Nigeria in any form, it may be difficult to conclude that such a company is liable to Companies Income Tax in Nigeria, although the company may be seen to have derived income from Nigeria. More so, such transactions may elude the tax authorities' radar and the transactions will not be liable to Value Added Tax (VAT) if the transactions are not deemed to have taken place in Nigeria. The Federal Inland Revenue Service (FIRS) is, however, making efforts to ensure that income arising from e-commerce is subjected to Nigerian tax. These efforts seem to have yielded some results in the aspect of indirect taxes as opposed to direct tax. In recent times, the FIRS has made attempts to assess some foreign mobile application transport operators to income tax in Nigeria on the basis that the income for services they provide is derived from Nigeria. However, the absence of the required fixed base or physical operations in Nigeria under Section 13 of CITA has made it difficult for the FIRS to establish liability of such foreign companies to Nigerian tax. To ensure that companies, particularly digital companies, do not escape tax in Nigeria, the FIRS has often required Nigerian companies to withhold tax on all payments made to non-resident persons regardless of the non-establishment of the tax presence specified under Section 13 of CITA. This requirement has encountered resistance from taxpayers given that such non- resident persons may not be liable to Nigerian tax under Nigerian tax laws.

In some cases, the FIRS seems to have succeeded in ensuring that VAT is deducted and accounted for on cross border payments for transactions between foreign companies and Nigerian companies.

In the recent Federal High Court (FHC) judgment in the case between Vodacom Business Nigeria Limited v FIRS, the FHC ruled in favour of the FIRS and held that the Nigerian company was required to account for the VAT on such transactions regardless of the fact that the supplier/foreign company did not perform the services in Nigeria. According to the FHC, the services are not expressly exempt from VAT and are thus liable to Nigerian VAT.

(b) To block tax revenue leakages associated with taxation of digital economy in Nigeria, the following action points should be considered:

(i) Review of the scope of "fixed base" under section 13 of CITA

Although Nigeria, just like India, is neither a member of the OECD nor the EU, it is important that the scope of "fixed base" under Section 13 of the CITA be expanded as is presently being proposed in India to ensure that the Nigerian digital economy is effectively captured for tax purposes. The introduction of a digital fixed base in Nigeria will certainly increase the tax base, thereby sharing the collective tax burden of taxpayers while ensuring an increase in government revenue.

(ii) Adoption of creative approach through innovative tax legislation

It has become expedient for the Nigerian tax authorities to explore a more creative approach to ensure taxation of the digital economy. Nigeria will need to borrow a leaf from other nations who have taken bold steps to tackle the non- taxation of the digital economy to plug revenue leakages through innovative tax legislation rather than seeking to extend the interpretation of obsolete legislations that are not sufficient to bring cross border digital transactions into the tax net. Given the peculiarities and innovations of the digital economy, it will be most appropriate for the Nigerian Government to enact a legislation to adequately cater for the taxation of the digital economy rather than trying to make it fit into existing tax laws.

(iii) Automation tax administration

Presently, FIRS has adopted the ITAS, an electronic filing platform as an indication of its seriousness to implement the aspirations lucidly expressed in the National Tax Policy (NTP) regarding the automation of the tax system. The NTP expects that "all processes starting from registration of taxpayers, filing of returns, audits and investigations, payment of taxes including correspondence with taxpayers will become automated. Where there are gaps in current tax laws or where the laws do not support the use of such systems, necessary amendments shall be made to ensure that the use of the systems are in line with the law".

The implication of this for the digital economy is two-fold. On one hand, full (or substantial automation) of the tax processes or system increases the degree of exposure of tax officers, administrators, taxpayers and other stakeholders in the use and mastery of those processes. On the other hand, it enhances the prospects of positioning the tax system and its electronic platforms for a robust and seamless interface with diverse payment platforms which can facilitate tracking of electronic transactions liable to tax in Nigeria.

Whilst it is tempting to assume the time is not ripe enough to mobilise resources to confront tax leakages from the digital economy (probably because there is evidence that FIRS is yet to maximize tax revenue from the registered taxpayers in the non-digital business front), the more reasonable course is to seek to deal with the tax leakages from the digital business simultaneously. The increasing number of business transactions that are consummated over digital platforms show that this is the way of the short to medium term future of business interactions.

(iv) Data handling

Another critical success factor in a digital economy is data handling. Elsewhere data is treated with something akin to reverence but Nigeria's data gathering and storage processes are still not fully integrated. This will require huge investments including for data protection as the recent ransomware "WannaCry" threat showed.

(v) Strategic partnership with digital economy service providers

The FIRS should form "a strategic partnership with institutions which provide platforms to consummate digital transactions in Nigeria. This would ensure that the objective of minimizing and reducing tax leakages especially from the digital economy is achieved at a faster pace.

(vi) Ratification of multilateral conventions

Ratification of multilateral conventions on tax related treaties to end profit shifting and tax evasion by multinational companies. The benefits are that the convention will swiftly modify existing bilateral tax treaties to implement tax treaty related matters in a cost efficient manner, instead of individual negotiations and amendment of the treaty. The treaty will address abuse of tax laws, raise government tax revenue, promote transparency and check illicit financial flows

(vii) Capacity development

There is need for capacity development for tax administrators so they can implement a seamless interface with the different payment systems available in Nigeria.

(2)

According to Organisation for Economic Cooperation and Development (OECD), a non-resident company is said to have significant economic presence (SEP) when it has "a purposeful and sustained interaction with the jurisdiction via digital technology and other automated means…"

Determination of SEP for digital activities

The Companies Income Tax (Significant Economic Presence) Order, 2020 ("the order") provides that a foreign company carrying on the business of digital services shall have a SEP in Nigeria in any accounting year, where it:

(a) Derives ₦25 million annual gross turnover or its equivalent in other currencies from any or combination of the following digital activities:

i. Streaming or downloading services of digital contents, including but not limited to movies, videos, music, applications, games and e-books to any person in Nigeria; or

ii. Transmission of data collected about Nigerian users which has been generated from such users' activities on a digital interface including website or mobile applications; or

iii. Provision of goods or services other than those under sub-paragraph 5 of the Order, directly or indirectly through a digital platform to Nigeria; or

iv. Provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers in Nigeria.

(b) Uses a Nigerian domain name (i.e., .ng) or registers a website address in Nigeria; or

(c) Has a purposeful and sustained interaction with persons in Nigeria by customizing its digital page or platform to target persons in Nigeria, including reflecting the prices of its products or services in Nigerian currency or providing options for billing or payment in Nigerian currency.

Determination of SEP for technical, professional, management and consultancy services

The Companies Income Tax (Significant Economic Presence) Order, 2020 ("the order") provides that a foreign company providing technical, professional, management or consultancy services shall have a SEP in Nigeria in any accounting year where it earns any income, or receives any payment from a person resident in Nigeria, or a fixed base or agent of a foreign company in Nigeria.

Professional level

Advanced Taxation

15

Taxation of non – residents

Contents

Taxation of non – residents

15.0 Purpose

After studying this chapter, readers should be able to:

(a) Identify what constitutes taxable income of non–residents;

(b) Apply relevant provisions of the Nigerian tax laws in ascertaining the assessments of non-residents;

(c) Determine non-residents tax liability in Nigeria; and understand the procedure for payment of relevant tax; and

(d) Understand the amendment introduced by the Finance Act, 2019 to taxation of non-residents in Nigeria.

15.1 Introduction

The concept of residence determines the extent to which the income of a taxpayer is liable to tax under a tax jurisdiction. In Nigeria, a resident person (individual or company) is assessable to tax on the global income.

This implies that the taxpayer is liable to tax on the income or profits **"accruing in, derived from, brought into, or received in Nigeria."** It also determines the scope of deductions that may be allowed for the purpose of computing an individual's chargeable income.

For income tax purposes, a person may be resident, non-resident or possess dual residence.

15.2 Chargeability to tax – resident individuals

An individual is regarded as resident in Nigeria throughout an assessment year if he:

(a) Is domiciled in Nigeria;

(b) Sojourns in Nigeria for a period or periods amounting to 183 days or more in any 12 month period; or

(c) Serves as a diplomat or diplomatic agent in Nigeria.

15.2.1 Resident individual and liability to tax

(a) The profit of a trade, profession or vocation is liable to tax in Nigeria regardless of the period for which such a trade, profession or vocation has been carried on.

(b) Employment income is liable to tax on the basis of residence or where the employment income is sourced.

15.2.2 Non-resident individual

A non-resident individual is a person who is not domiciled in Nigeria or who stays in Nigeria for less than 183 days but derives income or profits from Nigeria. A non-resident individual becomes liable to tax from the day he commences to carry on a trade, business, vocation, or profession in Nigeria. However, he is liable to tax in respect of employment income when he becomes resident, except if the income is sourced from Nigeria by virtue of being borne by a Nigerian employer.

A non-resident individual shall be liable to tax in Nigeria to the following extent:

(a) In case of earned income like trade, business, profession and vocation, they would be liable to tax in Nigeria in the hands of a non-resident to the extent of such income derived from Nigeria;

(b) In the case of unearned income like dividend, rent, interest and royalties, they would be liable to tax in Nigeria in the hands of a non-resident to the extent of such income received in or bought into Nigeria; and

(c) In the case of employment income, a non-resident will become liable to tax when he becomes resident in Nigeria regardless of where the employment duties are performed. In addition, employment incomes are liable to tax if the activities or duties for the employment are wholly or partly carried on in Nigeria. However, where the duties of employment are paid in Nigeria and there is an evidence that such salary has not been subjected to tax outside Nigeria, the tax shall be payable in Nigeria.

15.3 Resident and non-resident companies

15.3.1 Resident companies

A company is resident in Nigeria under the extant law, if it is incorporated or registered in Nigeria. Under the old provision, residence was being determined by place of management or control. This means that a company can be resident in Nigeria by incorporation and also resident in UK if it is managed and controlled in UK. This is known as international dual residence.

15.3.2 Non-resident companies

This is a company or corporation that is not registered or incorporated in Nigeria, but which derives income or profits from Nigeria. It is to be mentioned here, for the sake of emphasis, that exemption from incorporation does not confer exemption from payment of tax on any company. Every company, resident or non-resident, is liable to tax in Nigeria, if it's income is liable to tax under the provisions of the Companies Income Tax Act CAP C21 LFN 2004 (as amended).

The following are the circumstances under which a non-resident company will be liable to tax in Nigeria:

(a) Income derived through a fixed base or permanent establishment;

(b) Income derived in Nigeria through a dependent agent;

(c) Income derived from supervisory activity that lasts more than three months;

(d) Income derived in Nigeria from a turn-key project;

(e) Income derived by non-resident company from professional consultancy, management and technical services rendered in Nigeria.

(f) Income derived by a non-resident company from investment such as dividend, interest, rent and royalties. The withholding tax deducted from these incomes is taken as the final tax; and

(g) Income derived from a contract awarded to a Nigerian company, but sub-contracted to a non-resident company.

15.4 Dual residence

An individual or company may have dual or multiple residence status.

15.4.1 Dual residence of local individuals

Ordinarily, a resident individual is subject to tax in Nigeria in the state where the individual normally resides. In the case where such an individual has two or more places of residence in Nigeria for income purposes, he is subject to tax in the state where he has the **"principal place of residence"**. The term **"principal place of residence"** means, for an individual with:

(a) Pension as the only source of earned income, his usual residence constitutes the principal place of residence;

(b) Sources of earned income other than pension, the place nearest to his usual place of work; and

(c) Sources of unearned income, his usual residence.

Where the determination of the principal place of residence leads to dispute between two or more tax authorities, the Joint Tax Board determines the tax jurisdiction. In practice, the determining factor is the source of earned income.

15.4.2 Dual residence of a local company

The constitutional arrangement in Nigeria vests the taxation of all companies in the Federal Government. This does not allow for the dual residence of companies locally. All companies wherever located in Nigeria are under Federal tax jurisdiction. Therefore, the problem of local dual residence of companies does not arise.

15.4.3 International dual residence

The definition of the term "residence" differs from one country to the other. For instance, in Nigeria, the length of stay to qualify a taxpayer as a resident is reckoned within a 12 month period. In some countries, this is reckoned within an assessment year-allowing for a qualifying period of stay to split over two years of assessment. In some other countries (e.g. the USA), the citizen is regarded as resident in the home country whatever the length of stay abroad. This creates the problem of dual residence for the individual who is regarded as resident in more than one country. For example, he is regarded as resident at the same time in country A where nationality is the basis of residence, in country B where he has stayed for more than 183 days in a 12-month period and, may be, in his home country where he is away for less than 183 days in that assessment year.

A company may also have the problem of dual residence. For instance, the definition of the residence of a company in Nigeria is the place of incorporation. In some other countries, the relevant criterion may be the "place of management" or the "place of residence of the directors". In this instance, the Nigerian tax authority would treat the company as resident in Nigeria on the basis of the place of incorporation while the tax authority of the other country would regard the same company as resident in that other country on the basis of "place of management".

The Nigerian tax treaties (where applicable) govern the treatment of such cases and affected companies can claim tax credit for the Nigerian tax in their home countries to avoid double taxation.

15.5 Branches and the parent company

The tax laws of some countries regard a branch as resident, for tax purposes, in the same country as the parent company and therefore exempt the income of branches from tax. There is no such provision in the Nigerian tax law. A Nigerian branch of a foreign company is treated as a corporate entity under the law of the land and any income or profit derived by it from Nigeria is taxable here. The two conditions where a branch may not be so treated are:

(a) If the branch is used solely for storage or display of goods or merchandise; and

(b) If the branch is used solely for the collection of information.

15.6 Subsidiaries and the parent company

A subsidiary is expected to be incorporated in Nigeria to operate as a separate legal entity from the parent. The foreign equity-participation may be 100% but such equity-ownership or the control will not affect the residence status in Nigeria once the company incorporates. However, the claim to the contrary by the other country may raise all the problems of dual residence.

Article 4 of the Nigerian model double taxation agreement spells out the mode of resolving the problem of dual residence between Nigeria and a treaty-country.

The agreement provides for the criterion of "place of incorporation" as basis of resolving dual residence. Where this fails, the question is to be resolved by "mutual agreement".

15.7 Comparison of overseas branch with overseas subsidiary

15.7.1 Overseas branch

For tax purposes, the profit of an overseas branch of a Nigerian company is deemed to be derived in Nigeria and is therefore fully liable to tax in Nigeria. Note that any foreign tax suffered is allowable as a deduction in determining the overseas profit. Also, assets in use in such a branch are eligible for capital allowances claim in Nigeria. Losses incurred from such a branch can be set off against profit in Nigeria provided the losses were incurred from the same source.

Double taxation relief is available for any foreign tax suffered either based on bilateral agreement or based on tax relief available under the common wealth.

15.7.2 Overseas subsidiary

For tax purposes, the profit of an overseas subsidiary is not deemed to be derived in Nigeria and will therefore not be liable to tax in Nigeria. It is only dividend received from such overseas subsidiary that will be considered for Nigeria tax purposes. Also technical and management fees paid to the Nigerian company by the overseas subsidiary will be subjected to tax in Nigeria. Note that capital allowances will not be claimable on the assets of the overseas subsidiary. Loss can also not be relieved since there is no group taxation in the Nigerian tax law.

15.8 Treatment of expenses

The Nigerian tax laws do not discriminate between residents and non- residents in the allowance of expenses for the purpose of determining the taxable income. All expenses proved to be incurred for the production of the income are allowable as deductions. Rent, interest, royalties, management fees, head office expenses and similar expenses are deductible if proved that they are “wholly, exclusively, necessarily and reasonably” incurred for the purpose of the trade or business.

15.9 Profits or income “deemed to be derived from Nigeria”

Under the old law, the liability to the Nigerian tax on the income from a trade or business of a non-resident company or individual in Nigeria was restricted to that portion of the income attributable to the operations performed in Nigeria. This definition has been found to be inadequate in view of the growing complexities in the nature of commercial operations in Nigeria. The government is in favour of encouraging foreign investment and has therefore decided to state in clear and specific terms which activities of a non-resident company and individual would attract Nigerian tax and to what extent. Various amendments to the tax laws have attempted to define what constitutes the deemed profit or income from a trade or business carried on in Nigeria.

For companies, answers to the following questions will determine whether or not an income is deemed to be derived from Nigeria:

(a) Does the company have a “fixed base” in Nigeria?

(b) Does the company operate in Nigeria through a dependent agent authorised to conclude contracts?

(c) Is the company executing a turnkey project in Nigeria? or

(d) Is the operation between the company and its Nigerian subsidiary at arm’s length?

These specific circumstances will be treated in turns.

15.9.1 Fixed base of business

If a non-resident company has a “fixed base” from which it carries on its business or trade in Nigeria, the profits from such activities would be deemed to be derived from Nigeria.

The term “fixed base” implies that the place must be easily identifiable and must possess some degree of permanence. It includes:

(a) Facilities such as a factory, an office, a branch, a mine, gas or oil well, etc;

(b) Activities such as building, construction, assembly, or installation; and

(c) Furnishing of services in connection with the activities mentioned above. However, two cases are specifically exempted and these include:

   (i) Facilities used solely for storage or display of goods or merchandise; and

   (ii) Facilities used solely for the collection of information.

15.9.2 Operation of a dependent agent

A non-resident company can have two types of agents in Nigeria – an independent agent or a dependent agent. An agent is regarded as possessing independent status when he acts on behalf of a non-resident company in the ordinary course of his business. The status may however change if he devotes his activities wholly or almost wholly on behalf of the company.

Where a dependent agent makes an isolated sale of goods on behalf of a principal that may not necessarily constitute the income from such an operation, the deemed profit is not liable to Nigerian tax. However, where the facts show that the sale of goods on behalf of the principal or of any company associated to it by the agent is on a regular pattern, this arrangement will conform with the intention of the term “habitually”.

15.9.3 Profits on a turnkey project

A turnkey project is defined as a “single contract involving survey, deliveries, installation or construction.” The profit on a turnkey project is liable to tax in Nigeria. Such a profit should not be split between the so-called “Nigerian source” and “off-shore” profits but taxed wholly in Nigeria.

15.9.4 Transactions not at arm’s length

The legislation allows the Board to make appropriate adjustment to the profits of Nigerian companies where the following circumstances prevail:

(a) Where there is a controlling interest in the Nigerian company;

(b) The presence of a control of a Nigerian company may be exercised directly or indirectly by a parent company or any other company associated to it;

(c) The imposition of conditions in the financial and commercial relationship by the controlling interest;

(d) The conditions imposed must be different from what would obtain between independent parties or in an open market situation;

(e) Such relationship and conditions lead to the transfer of goods and services at prices not at arm’s length; and

(f) Consequently, the profits declared for the Nigerian tax are understated. The ‘imposition of conditions’ or control and influence as mentioned above can move in various appearances like over- invoice of goods and services, packaging of the terms of payment of interest on loans, frivolous charges for management fees, royalty, patent and rent, convenient shifting of profits between companies or in the allocation of expenses, all with the objective of minimising, avoiding or evading the Nigerian tax.

When the conditions analysed above hold, the profit deemed to be derived from Nigeria shall be as determined by the Board. In such circumstance, the Board will carry out comparative cost and price to establish the true market prices and make necessary adjustments to determine the true profit for tax purposes.

15.9.5 “Sales’ outlet”

The law has excluded:

(a) "Facilities used solely for storage of goods or merchandise"; and

(b) "Facilities used solely for the collection of information" from the facilities that would constitute a fixed base. The use of the word "solely" in the law implies that facilities used exclusively as a representative office would be exempted. Where, however, a facility is so exempted, but, qualifies as a "sales' outlet" it will be treated as a fixed base for the non-resident company. The profit arising from such a sales outlet is taxable.

Illustration 15.1
Sweet Home Inc has a representative branch in Nigeria for the display of its products. It was later discovered that sales were regularly conducted from the stock held for the display.

Suggested Solution 15.1
With the activity of the branch restricted solely to the display of the parent's products in Nigeria, the branch will retain the status of a representative office and will not be held liable to Nigerian tax. However, with the sales activity of the branch, the status of the branch has changed to a sales' outlet and this will turn it into the parent's fixed base in Nigeria and therefore become taxable on profits arising from the sales.

15.9.6 Employment income

Residence is the basis of taxing employment income in Nigeria. When the taxpayer is regarded as resident in Nigeria, his employment income is liable to Nigerian tax. The other conditions are as per paragraph below.

For employment income not to be liable to Nigerian tax, three conditions must hold viz:

(a) The employee must be resident for less than 6 months in any 12-month period;

(b) The employer of the person must not be resident in Nigeria; and

(c) Income of the person must be taxable in another country that has a double tax treaty with Nigeria.

15.10 Provisions of Finance Act, 2019 on Taxation of non-resident companies in Nigeria

The Finance Act, 2019 has introduced the following amendments to taxation of non-resident companies in Nigeria:

- Withholding tax shall be the final tax for technical, management, consultancy or professional fees earned by non-resident companies;
- A new clause imposing tax on profits of foreign companies for online and/or electronic commercial activities, if they are deemed to have significant economic presence (SEP) in Nigeria has been introduced. Significant economic presence to be as determined by the Minister;and
- Non-resident companies are to file corporate tax returns with the Federal Inland Revenue Service.

15.11 Chapter review

In this chapter, the detailed provisions concerning the taxable income of non-residents both individuals and companies are discussed.

It also addressed the dual residence of individuals, local and international companies.

15.12 Worked examples

15.12.1 Open- ended questions

15.12.2

(1) (a) To what extent are non-resident individuals liable to Nigerian income tax?

(b) Explain briefly:

(i) Resident company

(ii) Non-resident company.

(2) Robertson Andersen Incorporated of New Jersey, USA has R&A Nigeria Limited as its subsidiary in Nigeria. In 2017, the Federal Government of Nigeria awarded a contract to the foreign company for the construction of an Export Processing Zone located in the South East of Nigeria for the sum of $12 million. It decided for the sake of convenience to execute the contract through R & A Nigeria Limited.

The following are the expenses incurred for the execution of the contract.

	₦
Materials and other inputs	334,957,750
Hire of dredger	186,553,750
Foreign experts costs	156,785,500
Personnel costs	157,689,250
Other administrative costs	115,546,750

Additional information:

(i) A similar dredger is available for hire at ₦178 million at Bomil Limited.

(ii) The cost of foreign experts in carrying out similar assignments in the other zones has been established to be an average of ₦120.50 million.

(iii) Included in other administrative costs are management fees of ₦45 million. It was proved to have been wholly, exclusively, reasonably and necessarily incurred for the Nigerian contract.

(iv) Capital allowance was agreed at ₦74,221,750.

(v) The exchange rate is assumed to be N90 per $1.

Required:

(a) Compute the tax payable by the company for the relevant tax year.

(b) Discuss the issue of turnover assessment for a non-resident company in Nigeria.

(3) The Companies Income Tax Act CAP C21 LFN 2004 (as amended) provides three tests for determining whether the profits of a non- resident company from any trade or business shall be deemed to be derived from or accrue in Nigeria.

These tests are: the fixed base test; the agency test; and the turnkey contract test.

Required:

Explain in detail the meaning and implication of each test on liability to tax of a non-resident company.

(4) (a) To what extent are non-resident individuals liable to Nigerian income tax?

(b) Use the following figures to illustrate your answer and state how the tax liability is assessed:

	₦
Foreign earnings	1,800,000
Dividend received from Nigerian companies (NET)	650,000
Directors' fees received from a Nigerian company	3,000,000

15.12.3 Suggested solutions to open-ended questions

(a) Non-resident individuals are liable to tax in Nigeria to the extent that the income is derived from, accruing in, brought into or received in Nigeria. Simply put, this means that if an individual derives income from earning on a trade or business in Nigeria, aside from the business carried on in the other parts of the world, the income chargeable to tax in Nigeria is limited only to those incomes derived from the Nigerian operations.

In a similar manner, if an individual derives investment income from outside Nigeria but is not repatriated into Nigeria, no tax liability will arise in the hands of such a non-resident. The investment income is only charged to Nigerian tax if it is brought into Nigeria.

(b) Resident company

A company is deemed to be resident in Nigeria if it is incorporated or registered in Nigeria.

(c) Non-Resident company

A company is said to be a non-resident if such company is not registered or incorporated in Nigeria but derives income or profit from Nigeria.

2 (a) **Robertson Andersen Incorporated Computation of tax payable For 2018 tax year**

	₦	₦
Turnover ($12 million x ₦90)		1,080,000,000
Deduct:		
Materials and other inputs	334,957,750	
Hire of dredger	178,000,000	(512,957,750)
		567,042,250
Personnel costs	157,689,250	
Cost of foreign experts	120,500,000	

Other administrative costs	115,546,750	(393,736,000)
Assessable profit		174,221,250
Capital allowance	74,221,750	
C/A relieved	(74,221,750)	(74,221,750)
	NIL	
Total profit		**99,999,500**
Tax payable @ 30%		**29,999,850**
Tertiary education tax @ 2%		**3,484,425**

(b) The policy of the Federal Inland Revenue Service in the determination of the fair and reasonable percentage of the turnover of non-resident company are as follows:

(i) Where the activities carried on through a fixed base involved in construction, assembly or installation, or in the case of turnkey projects, the percentage of the turnover to be adopted to determine the assessable profit is 20%. The capital allowances are deemed to have been granted and at the current tax rate of 30%, this gives an effective rate of 6.0% of turnover.

(ii) Where the activity carried on through the fixed base or through the dependent agent involves consultancy, management, technical or agency services, the 10 percent withholding tax is treated as the tax payable.

Note that FIRS, effective from 2015, requires that non-resident companies liable to tax in Nigeria prepare and file their actual tax returns in a similar way as resident companies.

3. The key tests in the taxation of non-residents include:

(a) **Fixed base of business – S. 11(2)(a)**
The fixed base of non-resident company is the place from where it carries on its business or trade in Nigeria. The fixed base must be easily identifiable and must possess some degree of permanence. A fixed base will include:

(i) Facilities such as a factory, an office, a branch, a mine or an oil well;

(ii) Activities such as building, construction, assembly or installation; and

(iii) Furnishing of services in connection with the activities above. It is important to note that the following cannot be considered as a fixed base:

- Facilities used solely for storage or display of goods or merchandise; and
- Facilities used solely for the collection of information.

For an individual, the profit of an individual carrying on a trade or business in Nigeria through a fixed base shall be the profit attributable to that fixed base specifically:

- If the business is through a dependent agent, the profit attributable to that agent;

- If the business involves turnkey projects, the profit from that contract;

- If the business is through related parties, the profit determined on arms length principle by the relevant tax authority.

(b) **Agency operation – S. 11(2)(b)**

Where a non-resident does not have a fixed base in Nigeria but habitually operates a trade or business through a person in Nigeria:

(i) Authorised to conclude contracts on its behalf or on behalf of some other companies controlled by it or which has controlling interest in them.

(ii) Who habitually maintains a stock of goods or merchandise in Nigeria from which deliveries are regularly made by a person on behalf of the company, then an agency arrangement is deemed to have arisen. The profit deemed to have been derived from Nigeria is the profit attributable to the business or trade or activities carried on through the agent.

There may be two types of agents:

- Independent agent: an agent is regarded as possessing independent status when it deals on behalf of a non-resident company in its ordinary course of its own business. The implication of this arrangement is that the agent carries on its own trade along with his function as an agent of the non- resident company. Therefore, if the non-resident company stops trading in Nigeria, the independent agent is not materially affected as it will continue in its own business.

- Dependent agent: this occurs where the agent devotes his activities wholly or almost wholly on behalf of the non-resident company. Where a dependent agent makes an isolated sale of goods on behalf of the principal, such a profit may not necessarily be subjected to tax in Nigeria. Where however the sale of goods on behalf of the principal is on a regular basis, then the agent is deemed to trade habitually in the goods and the profit derived therefore is chargeable to tax in Nigeria.

(c) **Turnkey projects – S.11(2)(c)**

This is a trade or business or activity which involves a single contract for the surveys, deliveries, installations or construction. For Nigerian income tax purposes, the profit from such a turnkey project is considered as derived from Nigeria. Consequently, it is fully chargeable to tax in Nigeria because no allowance would be given for the profit to be divided into Nigerian and offshore.

4. (a) Non-resident individuals are liable to Nigerian income tax to the extent of their income derived from accruing in, brought into or received in Nigeria.

"Where an individual outside Nigeria carries on a trade or business of which only part of the operations are carried out in Nigeria, the gains or profits of the trade or business shall be deemed to be derived from Nigeria to the extent to which such gains or profits are not attributable to that part of the operations carried on outside Nigeria".

This means that the trading profits of a non-resident individual liable to Nigerian Income Tax is the part derived from a trade or business carried on in Nigeria. Also, as regards gains or profit from any employment, the duties of which are mainly performed outside Nigeria shall be deemed to be derived from Nigeria to the extent that those duties are performed in Nigeria. A non-resident individual shall be liable to tax on employment income unless all the specified conditions for exemption are met.

Furthermore, the income from a dividend paid by a company other than a Nigerian company, or from any other source outside Nigeria shall be the amount of that income brought into or received in Nigeria.

However, with effect from 1996, the following incomes shall be exempted from tax provided they are brought into Nigeria in convertible currency and paid into a domiciliary account in a bank approved by the government. The incomes include temporary guest, lecturer, teacher, nurse, doctor, dividend, rent, interest, incomes of a sportsman, author playwright, musician, etc.

(b) **Illustration**

MR. A . Non-resident

Computation of income tax payable for 2014 year of assessment

		₦
Earned income		
Directors' fees		3,000,000
Unearned income		
Dividends (Gross 650,000 x 100/90)		722,222
Total income		3,722,222
Less:Relief		
	Consolidated allowance 200,000 + 20% of 3,000,000	(800,000)
Chargeable income		2,922,222
	Less: Dividend treated as franked investment income	(722,222)
Taxable income		2,200,000
Apply tax table		
First N300,000 @ 7%		21,000
Next N300,000@11%		33,000
Next N500,000@ 15%		75,000
Next N500,000 @ 19%		95,000
Balance of N600,000@ 21%		126,000
		350,000

Tutorial notes

i. 2014 year of assessment was assumed;
ii. A non-resident individual is only entitled to consolidated allowance;
i. Foreign earnings are not liable to Nigerian income tax.
ii. Dividend is treated as franked investment income and therefore, exempted from tax.

Professional level

Advanced Taxation

16

Double taxation arrangement

Contents

DOUBLE TAXATION ARRANGEMENT

16.0 Purpose

After studying this chapter, readers should be able to:

(a) understand the meaning of tax treaty;

(b) understand the concept of double taxation relief;

(c) know the double taxation relief available to a company where there is no double taxation agreement.

(d) understand the double taxation relief available to a company where there is double taxation agreement.

(e) Identify the substance in a typical double taxation agreement between two countries using the agreement between Nigeria and United Kingdom as a model.

16.1 Tax treaty and double taxation relief

16.1.1 Introduction

A tax treaty is a formal bilateral agreement made by two countries to resolve issues involving double taxation of taxpayers' income, capital, estate and wealth between the two countries. For a double taxation agreement to be binding on Nigeria, it must not only be signed by the appropriate tax authority, it must also be approved by the Federal Executive Council and then ratified by both chambers of the Nigerian National Assembly.

When a Nigerian company earns foreign income, such will be included in its chargeable profit for the year and subjected to Nigerian tax.

In most cases, the amount that would be received in Nigeria would eventually be taxed twice – first in the country where the income originated and secondly in Nigeria where it is received. The tax burden on such income could be unduly high and it may appear as if the company receiving the income is being penalised for earning foreign income. In order to minimise the tax impact on such income, it is only reasonable that some relief from Nigerian taxation is given to the company. Section 44 of CITA deals with circumstances where there are no specific double taxation agreements while Sections 45 and 46 cover cases where there are agreements.

The tax payable in the foreign country is referred to as Commonwealth Income Tax. This is defined in Section 44(3) of the Act as "...any tax on income or profits of companies charged under a law in force in any country within the Commonwealth or in the Republic of Ireland which provides for relief from tax charged both in that country and Nigeria in a manner corresponding to the relief granted by this Section". "This Section" implies Section 44.

16.2 Commonwealth income tax relief

16.2.1 (Where there is no double taxation agreement) Section 44(1) deals with the Nigerian Companies.

Commonwealth income tax relief is given in a situation that a company which has paid or is liable to pay tax in Nigeria for any year of assessment on any part of its profits has also paid or is liable to pay Commonwealth income tax for that year in respect of the same part of its profit. The relief is used to reduce the tax paid or payable in Nigeria on the part of the company's profits which is liable to tax in Nigeria and in any country within the Commonwealth or in the Republic of Ireland.

Any claim for Commonwealth income tax relief for any year of assessment must be made not later than six years after the end of that year.

For example, if a company wishes to claim the relief in respect of profits earned in 2014 which were subjected to tax in 2015 year of assessment, the claim must be made on or before 31 December, 2021. If the claim is admitted, the amount of tax to be relieved will be deducted from the tax paid for that year of claim or set against the tax which the company is liable to pay for that year of claim.

The relief available to a Nigerian company from tax on its foreign income shall be:

(a) If the Commonwealth rate of tax does not exceed one - half of the Nigerian rate of tax, the Commonwealth rate of tax; and

(b) In any other case, half of the Nigerian rate. In other words, the rate of relief to be given to a Nigerian company is either the Commonwealth rate or half of the Nigerian rate, whichever is lower. Therefore, for Commonwealth rates of say 12% and 35% against the Nigerian rate of 30%, the relief available against tax on the foreign incomes received by a Nigerian company shall be 12% and 15%, respectively.

Section 44(2) covers non-Nigerian companies.

For a non-Nigerian company, the relief available shall be:

(a) If the Commonwealth rate of tax does not exceed the Nigerian rate of tax, one-half of the Commonwealth rate; and

(b) If the Commonwealth rate of tax exceeds the Nigerian rate, the amount by which the Nigerian rate exceeds one-half of the Common wealth rate.

For example, the foreign income of a non-Nigerian company received in Nigeria has suffered commonwealth rate at 28% and that of another company at 50%. With the current Nigerian rate at 30% the rate of relief shall be:

(a) For the first company, 14% that is half of Commonwealth rate – since the Commonwealth rate of 28% does not exceed the Nigerian rate of30%.

(b) For the second company, 5% that is the difference between the Nigerian rate(30%) and half of the Commonwealth rate (50% x½ = 25%) – since the Commonwealth rate of 50% is higher than the Nigerian rate of 30%.

It is not certain how this provision of Section 44(2) will be applied to non-Nigerian companies as such companies are liable to Nigerian tax only to the extent to which their income is derived from their operations in Nigeria. In other words, they are not liable to Nigerian tax on their foreign income.

Readers should note that the relief discussed above will be granted where there are reciprocal provisions in the tax laws of the country from where the income is being received.

16.2.2 Where there is Double Taxation Agreement

The provision of the law states “where there exists double taxation agreement between one country and Nigeria, the amount of relief available will be computed on the basis of the provisions of the agreement as contained in Sections 45 and 46of the Act”.

The points to note are:

(a) The provisions of section 44 of the Act shall have no effect;

(b) “Foreign tax” means any tax payable in a country which under the agreement is to be allowed as a credit against tax payable in respect of those profits in Nigeria;

(c) The tax payable on the worldwide income will be reduced by the credit admissible under the terms of agreement;

(d) Credit is allowable only for a Nigerian company;

(e) The total credit to be allowed for the foreign tax for any year of assessment, cannot exceed the total tax payable by the company for that year. In effect, no cash refund can be made in Nigeria for foreign tax paid;

(f) A company can elect not to take the benefit of the credit available under the arrangement in respect of the foreign profit earned by it, for the assessment year;

(g) Any claim for an allowance by way of credit shall be made not later than two years after the end of the assessment year; and

(h) In the event of any dispute as to the amount allowable, the claim shall be subject to objection and appeal in like manner as an assessment.

16.3 Double taxation agreement

A tax treaty or double taxation agreement is a formal bilateral agreement made by two countries to resolve issues involving double taxation of taxpayers’ income, capital, estate and wealth between the two countries. For a double taxation agreement to be binding on Nigeria, it must not only be signed by the appropriate tax authority, it must also be approved by the Federal Executive Council and then ratified by both chambers of the Nigerian National Assembly.

Features of a double taxation relief agreement

The following are some of the key features of a double taxation relief agreement:

(a) The names of the two countries involved in the agreements would be stated together with the definition of residence and person affected;

(b) The rates of tax applicable in the countries would be stated with a caveat that the rates may be changed without notice;

(c) The transactions on which double taxation relief is applicable. This will usually include business profit, fees, capital gains tax, etc;

(d) The arrangement for the exchange of information between the two tax authorities so as to minimize the incidences of tax evasion;

(e) The appeal procedures in the event of a dispute;

(f) The available diplomatic privileges for the taxpayers;

(g) The date of coming into force of the agreement and the possible termination date;

(h) Connected businesses including enterprises in the two countries under common control or where one has control over the other;

(i) The distinction in industrial and commercial profits especially for enterprises engaged in business partly in Nigeria and partly in other countries;

(j) The profits exempted from tax; and

(k) The methods by which the effect of double taxation is eliminated.

16.3.1 Double taxation agreement with United Kingdom

After the termination of all double taxation agreements between foreign countries and Nigeria, one of the earliest agreement that was signed was that with the United Kingdom.

The substance of the agreement is contained in the explanatory note to the schedule of the agreement. The following should be noted:

(a) Income from immovable property may be taxed in the country in which the property is situated (Article6).

(b) Business profits not arising through a permanent establishment are to be taxed only in the country of the taxpayer's residence. Profits attributed to a permanent establishment may be taxed in the country in which the permanent establishment is situated (Article 7).

(c) Profits or gains arising from the operation of ships and aircraft in international traffic are to be taxed only in the country of residence of the operator (Article8).

(d) Dividends derived by one company which is resident in one country from a company resident in another country may be taxed in that country in which the dividend is derived. The withholding tax applicable in Nigeria is reduced to7.5%.

(e) Interest arising in one country and paid to a resident of the other country may be taxed in that other country. The rate of tax in the source country is, in general, not to exceed 12.5 per cent. However, interest arising in one country and paid to the government or any government agency of the other country is to be exempt in the country of source (Article11).

(f) Royalties arising in one country and paid to a resident of the other country may be taxed in that other country. However, the rate of tax in the source country is not to exceed 12.5 per cent (Article12).

(g) Except with the exemption of profits or gains arising from the operation of ships and aircraft in international traffic, each country may tax capital gains in accordance with the provisions of its domestic law (Article13).

(h) Income derived by a resident of one country in respect of professional services or other independent activities of a similar character, shall be taxable only in that country, unless he has afixed base regularly available to him in the other country, for the purpose of performing his activities. In this case, so much of the income may be taxed in that other country as is attributable to that fixed base (Article14).

(i) Directors' fees and other similar payments derived by a resident of a country, in his capacity as a member of the board of directors of a company, which is a resident of the other country, may be taxed in that other country (Article 16).

(j) Income derived by artists and athletes may be taxed in the country where the activities are exercised (Article17).

(k) Where income continues to be taxable in both countries, credit will be given by the country of the taxpayer's residence in respect of tax imposed by the other country (Article22).

Foreign incomes exempted from Nigerian tax
With effect from January 1, 1988, investment incomes, namely; dividends, interests, royalties and rents, derived by a company from outside Nigeria, is exempted from Nigerian tax, provided that such income is brought into Nigeria through government approved channels. Government approved channels means the Central Bank of Nigeria, any bank or other corporate body appointed by the Minister as authorised dealers under the Second-tier Foreign Exchange Market, Act or any enactment replacing that Act. In such situations, there would not have been any double taxation and therefore there would be no need to grant any relief in form of tax credit.

16.4 Impact or benefits of double taxation agreement

These include:

(a) Avoidance of double taxation;

(b) Clarification of taxing rights of each contracting state;

(c) Encouragement of economic cooperation between states;

(d) Prevention of fiscal evasion with anti-avoidance provision; and

(e) Lowering of compliance cost.

16.5 Resolution of conflicts between double taxation agreements (DTAs and Nigerian tax laws

(a) Where a resident of a contracting state considers that the action of one or both of the contracting states result or will result from him in taxation not in accordance with this agreement, with the competent of the contracting state of which he is resident.

(b) The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to resolve the case by mutual agreement with the competent authority of the other contracting state, with a view to the avoidance of taxation not in accordance with the agreement.

(c) The competent authorities of the contracting state shall endeavour to resolve by mutual agreement any difficulties or doubt arising as to the interpretation or application of the agreement.

(d) The competent authorities of the contracting state may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

16.5.1 Active double taxation agreement

Tabular presentation of list of countries having double taxation agreement with Nigeria:

Countries	DTA type	Date/place of signing	Date of entry into force	Effective date
Canada	Comprehensive in Abuja	4 Aug 1992	16 Nov 1999	1 Jan 2000
Pakistan	Comprehensive in Lagos	10 Oct 1989	7 Mar 1990	1 Jan 1991
Belgium	Comprehensive in Brussels	20 Nov 1989	1 Jan 1990	1 Jan 1991
France	Comprehensive in Paris	27 Feb 1990	2 May 1991	1 Jan 1992
Romania	Comprehensive in Abuja	21 Jul 1992	18 Apr 1993	1 Jan 1994
Netherlands	Comprehensive in Lagos	11 Dec 1991	9 Dec 1992	1 Jan 1993
United Kingdo m	Comprehensive in London	9 Jun 1987	1 Jan 1988	1 Jan 1989
China	Comprehensive in Abuja	15 Apr 2005	21 Mar 2009	1 Jan 2010
South Africa	Comprehensive in Cape Town	29 Apr 2000	5 Jul 2008	1 Jan 2009
Italy	Air & Shipping Agreement Only in Lagos	22 Feb 1976	1977	1 Jan 1978
Philippines	Comprehensive in Manila	30 Sep 1987	18 Aug 2013	1 Jan 2014
Czech Republ ic	Comprehensive in Lagos	31 Aug 1989	2 Dec1990	1 Jan 1991
Slovakia	Comprehensive in Lagos	31 Aug 1989	2 Dec 1990	1 Jan1991

Date of entry into force of the DTA

System of both contracting states. In essence, the agreement becomes an enforceable law in both states because it has fulfilled necessary domestication procedures. This is provided for in Article 28 (1) of the various DTAs that;

"each of the Contracting States shall notify to the other the completion of the procedures required by its law for the bringing into force of this Agreement. The Agreement shall enter into force thirty days after the date of receipt of the latter of these notifications".

Effective date or date of application of the agreement

Both of these clauses are often used interchangeably. However, it is the date citizens of both Contracting States start benefiting from the agreement as provided for in article 28 (2) (a) (i)(ii) of the various DTAs. technically, the effective date of the agreement is the first day of the fiscal year following the date of entry into force of the agreement.

16.5.2 Implication of double taxation agreement on withholding tax deduction

A company resident in a country with no double taxation agreement with Nigeria will suffer withholding tax deduction at the rate of 10% of the value of revenue from a dividend, interest, and royalties while those from double taxation treaty will suffer withholding tax deduction on similar income only at reduced rate of 7.5%.

16.6 Definitions

16.6.1 Unilateral relief

This is the relief granted to mitigate the effects of international double taxation on the basis of domestic legislation rather than the provisions of a tax treaty. This relief is usually provided to taxpayers by home country irrespective of the any double taxation agreement with the country concerned and the relief usually exits because bilateral agreements might not be sufficient to meet all the cases. For instance, unilateral relief may be available against country A tax to a person resident in country A for foreign tax charged on income arising in a foreign country.

16.6.2 Multilateral treaties

A multilateral treaty is a written agreement between three or more sovereign states establishing the rights and obligations between the parties. They often result in international conference or gathering of nations done under the auspices of international organizations.

Also, multilateral treaties are single agreement between many countries. It allows a country to make concurrent changes to all or some of the double taxation agreements (DTAs) that it has with other countries. Countries that do a lot of trade with one another usually sign agreements for the avoidance of double taxation.

Example is a multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting. This treaty, usually referred to as the Multilateral Instrument (MLI), was drafted by the OECD to facilitate the implementation of the recommendations made by the OECD's BEPS Project to combat base erosion and profit-shifting by modifying the application of existing bilateral tax treaties. It also includes provisions to combat treaty abuse and improve dispute resolution mechanisms.

16.7 Nigerian double taxation agreements (DTA)

16.8.1 Permanent establishment (PE)

This mean a fixed place of business through which the business of an enterprise is wholly or partly carried on in Nigeria. It also includes any other form of taxable presence of a foreign enterprise in Nigeria. The fixed base of a foreign company is the place from where it carries on its business or trade in Nigeria. The fixed base must be easily identifiable and must possess some degree of permanence. A fixed base will include:

(i) Facilities such as a factory, an office, a branch, a mine or an oil well;

(ii) Activities such as building, construction, assembly or installation; and

(iii) Furnishing of services in connection with the activities above.

It is important to note that the following cannot be considered as a fixed base of a foreign company:

- Facilities used solely for storage or display of goods or merchandise;
- Facilities used solely for the collection of information.

For an individual, the profit of an individual carrying on a trade or business in Nigeria through a fixed base shall be the profit attributable to that fixed base specifically:

- If the business is through a dependent agent, the profit attributable to that agent;
- If the business involves turnkey projects, the profit from that contract;
- If the business as through related parties, the profit determined on arms length principle by the relevant tax authority.

16.8.2 Taxation of business profits and income from immovable properties

Business profits

(a) The profits of an enterprise of a contracting State shall be taxable only in that state unless the enterprise carries on business in the other contracting state through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profit of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

(b) Subject to provisions of paragraph (3) of this article where an enterprise of a contracting state carries on business in the other contracting state through a permanent establishment situated therein, there shall in each contracting state be attributed to that permanent establishment the profit which it might be expected to make if it is a distinct and separate enterprise engaged in the same or activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

(c) In the determination of the profit of a permanent establishment there shall be allowed as deductions expenses shown to have been incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere. However, no such deductions shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its offices by way of royalties, fees or other similar payment in return for use of or other rights, or by way of commission, for specific services performed or for management, or, except in the case of banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profit of a permanent establishment, for amount charged (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payment in return for the use of patents or other rights, or by way of commission for specific services performed or for management or except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

(d) No profits shall be attributed to a permanent establishment by the reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise:

Provided that where that permanent establishment is also used as a sales outlet for the goods or merchandise so purchased the profit on such sales may be attributed to that permanent establishment.

(e) Where profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of that Article shall not be affected by the provisions of this Article.

Immovable properties

i. Income derived by a resident of a contracting state from immovable property (including income from agriculture or forestry) situated in the other contracting state may be taxed in that other state.

ii. The term "immovable property" shall have the meaning which it has under the law of the contracting state in which the property in question is situated. the term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law landed property apply, usufruct of immovable property and right to variable or fixed payments as consideration for the working of or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as immovable property.

iii. The provisions of paragraphs (1) of this Article shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

iv. The provisions of paragraphs (1) and (3) of this Article shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

16.8.3 Taxation of investments income

(a) **Dividends**

i. Dividends derived from a company which is a resident of a Contracting State by a resident of the other Contracting State may be taxed in that other State.

ii. However, such dividends may also be taxed in the Contracting State of which the company paying the dividend is a resident according to the law of that State, but where the recipient of the dividend is subject to tax thereon in the other Contracting State, the tax so charged shall not exceed:

1. 12½ per cent of the gross amount of the dividend if the recipient is a company which controls directly or indirectly at least ten percent of the voting power in the company paying the dividend;

2. Fifteen per cent of the gross amount of the dividend in all other cases.

iii. The term "dividends" as used in this Article means income from shares, or any other item (other than interest relieved from tax under the provisions of Article 11 of this Agreement) which, Under the law of the Contracting State of which the company paying the dividend is a resident, is treated as a dividend or distribution of a Company.

iv. The provisions of paragraphs (1) and (2) of the Article shall not apply where the beneficial owner of the dividends, being a resident of one of the Contracting State, has in the other Contracting State a permanent establishment, or performs in that other State independent personal services from a fixed base situated therein, and the holding by virtue of which the dividends are paid is effectively connected with the business carried on through such permanent establishment or fixed base. In such a case the provisions of Article 7or 14, as the case may be, shall apply.

v. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other state may not impose any tax on the dividends paid by the company and beneficially owned by persons who are not residents of the other state, or subject to the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in that other State.

vi. The provisions of this Article shall not apply if the right giving rise to the dividends was created or assigned mainly for the purpose of taking advantage of this Article and not for bonafide commercial reasons.

(b) **Interest**

i. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

ii. However, such interest may also be taxed in the Contracting State in which it arises, and according to the law of that State, but where such interest is paid to a resident of the other Contracting State who is subject to tax there in respect thereof, the tax so charged shall not exceed 12 ½ per cent of the gross amount of the interest.

iii. Notwithstanding the provisions of paragraph (2) of this article, interest arising in a Contracting State shall be exempt from tax in that State if it is derived and beneficially owned by the Government of the other Contracting State or a local authority.

iv. The provisions of paragraphs (1) and (2) of this article shall not apply if the beneficial owner of the interest, being a resident of contracting state, has in the other contracting state in which the interest arises a permanent establishment situated therein, or perform in that other state independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest paid is effectively connected with that permanent establishment or fixed base. in such a case the provisions of article 7 or article 14as the case may be, shall apply.

v. Interest shall be deemed to arise in a contracting state when the payer is that state itself a political sub-division, a local authority or a resident of that state. where, however the person paying the interest, whether he is a resident of a contracting state or not has in contracting state permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, then such interest shall be deemed to arise in the state in which the permanent establishment or fixed base is situated.

vi. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest paid exceeds, for whatever reason the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provision of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement.

vii. The term interest" as used in this article means income from debt claims of every kind, whether or not "secured by mortgage and whether or not carrying a right to participate in the debtor's profits and in particular, income from government securities and income from bonds or debentures.

viii. The provisions of this article shall not apply if the debt-claim giving rise to the interest was created mainly for the purpose of taking of this article and not for bona-fide commercial reasons.

Note: The Federal Government of Nigeria through its 1999 budget and fiscal measures approved a lower treaty rate of 7 ½ per cent on dividends, interest, rent and royalties when paid to bona-fide beneficial owner of a treaty country.

16.8.4 Dispute resolution mechanism

It is hardly possible to ignore the effect of double taxation in the era of globalization. Therefore, countries sign bilateral double tax treaties (DTTs) to avoid or mitigate double taxation in cross border economic activity.

DTTs are signed between two countries to allocate tax jurisdiction between them and to avoid tax disputes between the taxpayer and the country concerned. Nonetheless, tax disputes crop up since such treaties may be open to interpretation at the time of implementation. Hence, DTTs contain tax dispute resolution mechanism.

The widely recognized dispute resolution mechanisms are:

i. The mutual agreement procedure (MAP)

This is a kind of negotiation between the two contracting state. This procedure enables the contracting parties to apply the substantive provisions contained in bilateral tax treaties which allocate taxing rights between contracting states. The power to administer MAP is entrusted to the competent authorities. These authorities are the organs normally responsible for the administration of the tax treaties.

The role of the competent authorities under the MAP is to "endeavor to resolve" by mutual agreement difficulties or doubts emanating from the application of the treaties. With a view to ensuring the proper functioning of the tax authorities, the taxpayers has been given right to request the competent authority to adjust their tax liabilities in accordance with the tax treaty when they (the taxpayers) believe that they are not taxed in accordance with the substantive rules of the treaty.

ii. Arbitration of international tax dispute

This is the use of compulsory arbitration to settle international tax disputes. It allows the taxpayer to initiate an arbitration process if the MAP fails after two years from the date of its commencement. It is to be noted that the taxpayer is allowed to invoke arbitration only when the competent authority has initiated a MAP and the tax dispute has not been resolved by the negotiation of the competent authorities.

16.9 Chapter review

This chapter discusses tax treaties and the concept of double taxation relief, especially where there is no double taxation agreement among countries and where there is a double taxation agreement in place.

The chapter also discusses some of the countries that have double taxation agreements with Nigeria and applicable withholding tax rates for transactions between a Nigerian company and a company based in countries that have double taxation agreements with Nigeria.

The readers must have learnt available mechanism for resolving issues that may arise under double taxation treaty.

16.10 Worked examples

16.10.1 Open-ended questions

1 John Awgu & Co. Limited is a firm of medical practitioners with a clinic in Lagos. In 2017, the operations of the company was extended to a neighbouring commonwealth country. The results of its business operations for the year ended 31 December 2017, for both domestic and foreign transactions as follows:

	Lagos Clinic	**Foreign Clinic**	**Total**
	₦	**₦**	**₦**
Fees	1,500,000	5,000,000	6,500,000
Sales of drugs	850,000	2,500,000	3,350,000
	2,350,000	7,500,000	9,850,000
Less: Expenses			
Staff salaries	920,000	1,500,000	2,420,000
Electricity & rates	15,000	250,000	265,000
Motor vehicle maintenance	45,000	55,000	100,000
Depreciation of Asset	145,000	250,000	395,000
Purchase of drugs	450,000	500,000	950,000
Bank charges & interest	50,000	17,000	67,000
Foreign taxes suffered	-	1,510,000	1,510,000
Miscellaneous expenses	150,000	250,000	400,000
	1,775,000	**4,332,000**	**6,107,000**
Profit	**575,000**	**3,168,000**	**3,743,000**

Additional information:

(a) The capital allowance of ₦1,450,000 was agreed with the Federal Inland Revenue Service.

(b) The Company is a wholly Nigerian Company.

Required:

Compute the Income tax liability of John Awgu & Co. Limited for the relevant year of assessment stating clearly the double tax relief applicable to the company.

2 Explain the concept of Double Taxation Relief.

(b) State the objectives of Double Taxation with another country.

(c) State the incomes exempted from Double Taxation.

3. What are the essential features of a Double Taxation Relief Agreement?

4. With respect to Double Taxation Arrangement, state precisely the provisions in respect of the following:

(a) Business Profits not arising through a permanent establishment.
(b) Profits or gains arising from the operation of ships and aircrafts.

(c) Interest arising in one country and paid to a resident of the other country.

(d) Dividends derived by one company which is resident in one country from a company resident in another country.

(e) Director's fees and other similar payments derived by a resident of a country in his capacity as a director of a company which is a resident of the other country.

5. AD International Limited runs a pharmacy practice in Nigeria and Ghana. The company's operating results for the year ended 31 December 2016 are as follows:

	₦
Income from Nigeria	50,000,000
Income from Ghana	22,000,000
Total income	**72,000,000**
Less: Overheads	(40,000,000)
Net profit	32,000,000

Included in the overheads were:

(a) Depreciation – Nigeria business	-	4,500,000
(b) Depreciation – Ghana business	-	750,000
(c) Donations to clubs in Nigeria	-	250,000

(d) Foreign tax suffered	-	4,200,000
(e) Profit attributable to Ghana business	-	5,150,000

Capital allowances for Nigeria and Ghana businesses were ₦3,540,000 and ₦1,450,000, respectively.

Assume the company is a wholly owned Nigerian company.

Required:
Compute the tax liabilities on the Total income, stating clearly the double taxation relief applicable to the company.

16.10.2 Suggested solutions to open-ended questions

1. John Agwu & Co. Ltd
Computation of Adjusted Profit for 2008 assessment year

	₦	₦
Net profit as per accounts		3,743,000
Add back:		
Depreciation of assets	395,000	
Foreign tax suffered	1,510,000	1,905,000
Assessable profit		**5,648,000**

John Agwu& Co. Ltd.
Income tax computation

	₦	₦
Assessable profit		5,648,000
Capital allowance	1,450,000	
C/A relieved	(1,450,000)	(1,450,000)
Total profit	NIL	**4,198,000**
Income tax @ 30%		1,259,400
Less: double tax relief (15% of N4,010,278)		(601,542)
Final tax liability		**657,858**

Computation of adjusted profit for foreign business

	₦	₦
Net profit per foreign a/cs		3,168,000
Add back:		
Depreciation	250,000	
Foreign tax	1,510,000	1,760,000
Adjusted profit		4,928,000

Deduct capital allowance			(917,722)
Total profit			4,010,278

Commonwealth rate of tax = $\frac{1,510,000}{4,010,278}$

= 37.65%

Nigerian Rate = 30%

Since Commonwealth rate of tax exceeds one half of Nigerian rate, one half of the Nigerian rate is applicable for double tax relief.

Workings: Allocation of capital allowances:

Lagos Clinic = $\frac{145,000}{395,000} \times 1,450,000$ = 532,278

Foreign Clinic = $\frac{250,000}{395,000} \times \frac{1,450,000}{1}$ = 917,722

2. (a) Double taxation relief is a bilateral agreement between two countries with the aim of exempting certain classes of incomes already subjected to tax in another country from further tax in the hands of the recipient.

(b) The objectives of double taxation with another country include:

(i) Avoidance of double taxation;

(ii) Lowering of compliance cost;

(iii) Prevention of fiscal evasion and avoidance;

(iv) Co-operation in tax matters; and

(v) Certainty of tax treatment.

(c) Types of incomes exempted from double taxation

(i) The remuneration of a professor or a teacher who is resident for not more than two years in the other country for the purpose of teaching.

(ii) Government pensions except the recipient is ordinarily resident in Nigeria.

(iii) Aircrafts and shipping profits.

(iv) Dividends paid by the other contracting states to a Nigerian resident who has no permanent establishment.

(v) Payments to a student or apprentice during his full time education or training in Nigeria.

3. Features of a double taxation relief agreement

The following are some of the key features of a double taxation relief agreement:

(a) The names of the two countries involved in the agreements would be stated together with the definition of residence and person affected

(b) The rates of tax applicable in the countries would be stated with a caveat that the rates may be changed without notice;

(c) The transactions on which double taxation relief is applicable. This will usually include business profit, fees, capital gains tax, etc;

(d) The arrangement for the exchange of information between the two tax authorities so as to minimize the incidences of tax evasion;

(e) The appeal procedures in the event of a dispute;

(f) The available diplomatic privileges for the taxpayers;

(g) The date of coming into force of the agreement and the possible termination date;

(h) Connected businesses including enterprises in the two countries under common control or where one has control over the other;

(i) The distinction in industrial and commercial profits especially for enterprises engaged in business partly in Nigeria and partly in other countries;

(j) The profits exempted from tax;

(k) The methods by which the effect of double taxation is eliminated;

4. (a) Business profits not arising through a permanent establishment are to be taxed only in the country of the taxpayer's residence. Profits attributed to a permanent establishment may be taxed in the county in which the permanent establishment is situated (Article7).

(b) Profits or gains arising from the operation of ships and aircraft in international traffic are to be taxed only in the country of residence of the operator (Article8).

(c) Interest arising in one country and paid to a resident of the other country may be taxed in that other country. The rate of tax in the source country is, in general, not to exceed 12.5 per cent. However, interest arising in one country and paid to the Government or any government agency of the other country is to be exempt in the country of source (Article11).

(d) Dividends derived by one company which is resident in one country may be taxed in that country in which the dividend is derived. However, the rate of tax in the source country is not to exceed 12.5% where the recipients a company controlling at least 10 per cent in all other cases (Article10).

(e) Directors' fees and other similar payments derived by a resident of a country, in his capacity as a director of a company which is a resident of the other country, may be taxed in that other country (Article 16)

5. **AD International limited 2017 income tax computations**
Basis period: 01/01/16 – 31/12/16

	₦	₦
Net profit per accounts		32,000,000
Add:		
Depreciation – Nigeria	4,500,000	
Depreciation – Ghana	750,000	
Donations to clubs – Nigeria	250,000	
Foreign tax suffered	4,200,000	9,700,000
Assessable profit		41,700,000
Deduct:		
Capital allowance – Nigeria	3,540,000	
Capital allowance – Ghana	1,450,000	
(Maximum of 662/3% of N41,700,000)		(4,990,000)
Total profit		**36,710,000**
Income tax at 30%		11,013,000
Less: double taxation relief (15% of N8,650,000)		(1,297,500)
Final tax liability		**9,715,500**
Tertiary education tax - 2% of assessable profit of ₦41,700,000		834,000

Computation of total profit for Ghana business

	₦	₦
Net profit per Ghana accounts		5,150,000
Add:		
Depreciation	750,000	
Foreign tax	4,200,000	4,950,000
Assessable profit		10,100,000
Less: capital allowances		(1,450,000)
Total profit		8,650,000

Commonwealth rate of tax	=	$\frac{4,200,000}{8,650,000}$ x100%	=48.55%

Nigeria income tax rate 30%

Note:
Since the Commonwealth rate of tax exceeds one half of Nigerian rate, one half of Nigerian rate is applicable for double taxation relief.

17

Transfer pricing

Contents

Transfer pricing

17.0 Purpose

After studying this chapter, readers should be able to:

(a) Understand the provisions of Income Tax (Transfer Pricing) Regulations 2018 that revoked the Income Tax (Transfer Pricing) Regulations No 1,2012;

(b) Apply the various laws on the assessment of companies;

(c) Identify related parties and transactions and their effects on total profits and assessments;

(d) Identify and treat appropriately transferred goods and services between Multinational companies;

(e) Describe some transfer pricing guidelines and methods by OECD;

(f) Understand the transfer pricing documentation process;

(g) Know the differences between transfer pricing policy and transfer pricing compliance document;

(h) Know the contents of transfer pricing declaration and disclosure forms as prescribed by the Federal Inland Revenue Service;

(i) Know the timing for filing of transfer pricing returns; and

(j) Know the administrative penalty applicable to taxable persons that failed to comply with transfer pricing regulation.

17.1 Introduction

Transfer price is the price charged for goods or services supplied or transferred by one subunit of an organisation to another subunit or one member of a group to another. It is also referred to as the price at which an enterprise transfer physical goods and intangible property or provides services to associated enterprises. With particular reference to multinationals companies, transfer pricing is a mechanism used by the multinationals to transfer goods and services between their related or associated companies worldwide. A transfer price may be determined based on the external market price (or open market price) for a similar product (market-based transfer price) or it may be based on the cost incurred in making the product (cost-based transfer price) or it may be determined through negotiation between the subunits or members of a group buying and selling the product (negotiated transfer price).

The rule for transfer pricing implementation in Nigeria is governed by The Income Tax (Transfer Pricing) Regulations 2018 which replaced the Income Tax (Transfer Pricing) Regulations No.1, 2012. This implies that although transfer pricing is not new in

Nigeria but the laws regulating it were first put together in 2012.

From the foregoing, transfer pricing refers to the prices at which the following are transferred between connectable taxable persons:

i. Tangible goods (raw materials, spare parts, finished goods, etc);
ii. Services (marketing, legal, accounting, insurance, management services, training, etc);and
iii. Intangibles (trademarks, patents, copyright, etc).

17.1.1 Advice on transfer pricing base on Organization for Economic Cooperation and Development (OECD) guidelines

The challenge for developing and transitioning countries in the development of transfer pricing legislation is in essence the same as for OECD countries: protecting their tax base while not creating double taxation or uncertainties that could hamper foreign direct investment and cross-border trade. The adoption of transfer pricing legislation embodying the arm's length principle can be instrumental in achieving this dual objective.

The suggested approach is based on the arm's length principle underlying Article 9 of the OECD Model Tax Convention on Income and on Capital ("the OECD Model") as that principle is elaborated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("the OECD Transfer Pricing Guidelines").

Dozens of countries around the world have implemented transfer pricing laws, and virtually all of them are based on the arm's length principle. With regard to transfer pricing of goods, technology, trademarks and services between associated enterprises and the methodologies which may be applied for determining correct prices where transfers have been on other than arm's length terms, the Contracting States will follow the OECD principles which are set out in the OECD Transfer Pricing Guidelines. These conclusions represent internationally agreed principles and the Group of Experts recommends that the Guidelines should be followed for the application of the arm's length principle which underlies the article.

Alignment of domestic transfer pricing rules with the internationally accepted principles set forth in the OECD Transfer Pricing Guidelines can:
• Provide countries with the tools they need to fight artificial shifting of profits out of their jurisdiction by multinational enterprises ("MNEs");

• Provide MNEs with some certainty of treatment in the country concerned;
• Reduce the risk of economic double taxation;
• Provide a level playing field between countries, which is less likely to distort the pattern of international trade and investment; and

• Provide a level playing field between MNEs and independent enterprises doing business within a country

17.1.2 Advice on transfer pricing base on United Nations(UN) guidelines

The UN Model Tax Convention Article 9(1) states that, where:
(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,
and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of these conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly".

In other words, the transactions between two related parties must be based on the arm's length principle (ALP). The term arm's length principle itself is not a term specifically used in Article 9, but is well accepted by countries as encapsulating the approach taken in Article 9,14 with some differing interpretations as to what this means in practice. The principle laid out above in the UN Model has also been reiterated in the OECD Model Tax Convention and the OECD Guidelines as supplemented and amended.

Thus, the arm's length principle is the accepted guiding principle in establishing an acceptable transfer price under Article 9 of the UN Model. The arm's length principle by itself is not new; it has its origins in contract law to arrange an equitable agreement that will stand up to legal scrutiny, even though the parties involved may have shared interest.

17.1.3 Advice on transfer pricing base on Pacific Association of Tax Administrator (PATA)

Pacific Association of Tax Adminstrator (PATA) members which include Australia, Canada, Japan and the United States have endeavored to develop a set of principles and document guidelines pursuant to which multinational taxpayers may create and maintain a single package of transfer-pricing records and documentation (hereinafter the "PATA documentation package") in order to satisfy the transfer-pricing documentation requirements of all PATA members. By providing a uniform transfer-pricing documentation package, PATA's goal is to facilitate the efficient preparation and maintenance of transfer-pricing documentation thereby enabling the timely production of such information upon request by tax auditors.

This PATA Documentation Package is not intended to impose legal requirements greater than those imposed under the local laws of a PATA member. In this regard, it should be noted that each PATA member has different legal systems, statutes, regulations and administrative approaches with respect to transfer pricing.The PATA members, after reviewing their respective domestic laws regarding transfer pricing and documentation of controlled transactions, agree that a multinational enterprise ("MNE") will satisfy each PATA member's documentation provisions by complying with all of the principles contained in this PATA Documentation Package, and will thus avoid the imposition of the PATA members' transfer pricing documentation-related penalties with respect to the documented transactions. However, satisfaction of the principles of this PATA Documentation Package does not preclude PATA member tax administrations from making transfer pricing adjustments.

17.2 Justifications for the application of transfer pricing regulations by multinational and developing countries

Transfer pricing has become a topical issue in world of taxation in recent years and regulations have increased due to two important reasons.

The first is the issue of prevention of fiscal evasion. In the absence of regulations, multinational companies have the tendencies of using transfer pricing to shift profit from one tax jurisdiction to another. The motivation for this is usually to reduce the global tax burden of the group as a whole. Profit is usually shifted from jurisdictions with high tax rate to areas where no or little tax is payable. Governments world over are protecting their tax base, and making paradigm shift to tax revenue especially with the dwindling revenue from other sources.

The second most important reason is to avoid economic double taxation which occurs where transfer pricing adjustment is done in one tax jurisdiction without a corresponding adjustment in the other tax jurisdiction.

Abusive transfer pricing practices are considered to pose major risk to the direct tax base of many countries and developing countries are particularly vulnerable because corporate tax tends to account for a larger share of their revenue. Therefore, developing countries need to develop appropriate transfer pricing regulations that will protect their tax base and raise additional revenue while maintaining favorable investment climate and take into consideration investor confidence.

17.3 Significance of transferpricing

Transfer prices at which goods and services are transferred between entities are significant for both taxpayers and tax authorities. This is so because they impact on the income and expenses as well as taxable profits of related companies in different tax jurisdictions in which the enterprise and multinationals operate. Transfer pricing mechanism is usually adopted by many companies to boost their head office profits which may be at the disadvantage of subsidiaries or associated companies which operate in other countries with different tax jurisdictions.

17.4 Legal framework for transfer pricing

Transfer pricing in Nigeria is regulated by the existing tax laws which are as follows:

(a) Section 22 of the Companies Income Tax Act CAP C21 Laws of the Federation of Nigeria 2004 (as amended by the Companies Income Tax (Amendment) Act 2007;

(b) Section 17 of the Personal Income Tax Act, CAP P8, Laws of the Federation of Nigeria, 2004 (as amendment by the Personal Income Tax (Amendment) Act2011);

(a) Section 15 of the Petroleum Profits Tax Act CAP P13 LFN 2004(as amended by the Petroleum Profits Tax (Amendment) Act2007;

(b) Section 61 of the Federal Inland Revenue (Establishment) Act2007; and

(c) The Income Tax (Transfer Pricing) Regulation Act of2018.

In exercise of the powers conferred by section 61 of the Federal Inland Revenue Service (Establishment) Act, No 13 of 2007 (“the Act”) and all other powers enabling it in that behalf, the Board of the Federal Inland Revenue Service established under section 3 of the Act (“the Board”) with the approval of the Minister enacted the Income Tax (Transfer Pricing Regulations), 2018.

17.4.1 Highlight of the Income Tax (Transfer Pricing) Regulations, 2018 that revoked the Income Tax (Transfer Pricing) Regulations No 1,2012

The commencement date for Income Tax Transfer Pricing Regulations No 1, 2012 was August 2, 2012 but taxpayers are expected to commence filing of transfer pricing returns from 2013 year of assessment. The commencement date for Income Tax Transfer Pricing Regulations, 2018 was March 12, 2018. Every taxpayer is therefore expected to develop transfer pricing policy in regards to transfer pricing and control transaction, as well as treatment of transactions of permanent establishment (PE) and dispute resolution.

17.4.2 Purpose, objectives and scope of application of transfer pricing regulations

(a) **Purpose**

The 2018 regulations give effect to the provisions of:

(i) Section 22 of the Companies Income Tax Act CAP C21 Laws of the Federation of Nigeria 2004 (as amended by the Companies Income Tax (Amendment) Act2007.

(ii) Section 17 of the Personal Income Tax Act, CAP P8, Laws of the Federation of Nigeria, 2004 (as amendment by the Personal Income Tax (Amendment) Act2011).

(iii) Section 15 of the Petroleum Profits Tax Act CAP P13 LFN2004 (as amended by the Petroleum Profits Tax (Amendment) Act 2007.

(iv) Capital Gains Tax Act, CAP, C1, Laws of the Federation of Nigeria, 2004.

(v) Value Added Tax Act, CAP, V1,Laws of the Federation of Nigeria, 2004.

(b) **Objectives**

The objectives of the regulations are to:-

(i) Ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activities deployed by taxable persons in Nigeria, including in their transactions and dealings with related persons;

(ii) Provide the Nigerian authorities with the tools to fight tax evasion through over or under-pricing of controlled transactions between related persons;

(iii) Reduce the risk of economic double taxation;

(iii) Provide a level playing field for both multinational enterprises and independent enterprises carrying on business in Nigeria; and

(iv) Provide taxable persons with certainty of transfer pricing treatment in Nigeria.

(c) **Scope**

(i) The regulations shall apply to transactions between connected taxable persons carried on in a manner not consistent with the arm's length principle and includes:-

- » sale and purchase of goods and services;
- » sales, purchase or lease of tangible assets;
- » transfer, purchase, licence or use of intangible assets;
- » provision of services;
- » lending or borrowing of money;
- » manufacturing arrangements; and
- » any transaction which may affect profit or loss, or any other matter incidental to, connected with, or pertaining to the transactions referred to in the regulation.

(ii) For purposes of applying these regulations, a permanent establishment and its head office are treated as separate entities who are connected persons and any transaction or dealing between a permanent establishment and its head office or other connected persons shall be considered to be a controlled transaction.

17.5 Arm's length principle

Every taxpayer is expected to comply with arm's length principle in dealing with transactions between related entities. The enterprise and multinationals are expected to be guided with the following principles:

a. Where a connected person has entered into a transaction or series of transactions to which these regulations apply, the person shall ensure that the taxable profits resulting from the transaction or transactions are ascertained in a manner that is consistent with the arm's length principle;

b. A controlled transaction is at arm's length if the conditions of the transaction do not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances; and

c. Where a connected person fails to comply with the provisions of this regulation, the Service shall make adjustments, where necessary, in order to bring the taxable profits resulting from the transactions in conformity with the arm's length principle.

17.6 Transfer pricing and multinational companies

Multinational corporations which are also known as multinational companies, are corporate organisations that own or control production of goods or services in two or more countries other than their home countries. Put differently, such companies have offices and /or factories in different countries and usually have a centralised head office where they coordinate overall management.

In Nigeria today, multinational companies such as ExxonMobil, Total, Chevron, Agip, Shell Petroleum Development Company, etc. now dominate the oil sector. Other sectors of the Nigerian economy with multinational companies is manufacturing with the likes of Cadbury, Guinness, PZ, Nestle, Unilever, Procter and Gamble, GlaxoSmithKline, Reckitt Benckiser, etc. MTN, Airtel, 9Mobile are also examples of multinational companies in telecommunication sector.

17.6.1 Different pricing of goods / services at purchase cost

In any multinational group, a member of the group in one country may supply goods or services to another member in another country. By implication, the prices charged often create revenue for the company selling the goods or services whilst it is cost of purchase for the company buying the goods or services.

17.6.2 Tax avoidance

When companies operating under different jurisdictions belong to the same group, they may decide depending on what they want to achieve, under price or over price inter group transactions. The tax implication of the foregoing is that multinational transfer pricing can provide an avenue for tax avoidance.

17.6.3 Custom duties and tariff manipulation

Customs duties paid on imports and exports are usually based on transfer prices. For instance, if the transfer prices on imports into a country are low-priced, the import duties and other tariffs on the imports will equally be reduced.

17.6.4 Dividends manipulation

An instance of dividends manipulation is when a country A restricts an amount that can be paid as dividend to another company in country B; the company in country B may decide to overprice goods and services transferred to its subsidiary in country A. The implication of the foregoing is that more funds will be remittable to the other company in country B without any violation on restriction of dividend.

17.6.5 Imposition of excessive charges

The parent company can also impose excessive charges (e.g. royalties) on its foreign subsidiaries, associates, etc in respect of the provision of intangibles such as patents, licenses, trademarks, etc and use these avenues to extract profits to a tax haven or jurisdictions with favourable tax requirement.

Where the head office of the multinational or a member of the group incurs expenses which are for the benefits of all or many members of the group, the allocation of the joint costs to members of the group will certainly affect their profits and taxes.

It is the practice of tax authorities in Nigeria to ensure that transactions between connected persons or related parties are not made at arm’s length to reduce tax liability.

Multinational enterprises (MNEs) play a key role in a global economy. Governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdictions and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein.

According to Organisation for Economic Cooperation and Development (OECD), it is advisable that taxpayers should limit the risks of economic double taxation that may result from a dispute between two countries on the determination of the arm's length in their cross-border transactions with associated enterprises.

17.7 Transfer pricing methods and evaluation of taxpayer's controlled transactions

Determination of appropriate market prices of products and services which will reflect arm's length transactions is usually difficult due to unavailability of similar products or services with which to be compared in the open market.

Even though tax legislations in Nigeria have not dealt specifically with the subject of transfer pricing, the tax Acts empower the tax authorities to set aside the prices charged in related parties' transactions if same are not made at arm's length to reduce tax avoidance.

(a) According to section 5 (1) of the Act, the following transfer pricing methods can be applied to determine whether the result of a transaction or series of transactions are consistent with the arm's length principle are as follows:

i. The comparable uncontrolled price (CUP)method;

ii. The resale price method;

iii. The cost plus method;

iv. The transactional net margin method; or

v. The transactional profit split method; and

Any other method which may be prescribed by regulations made by the service from time to time.

Transfer pricing methods can be broadly divided into two thus:

- Traditional transaction methods (i-iii) above ;and
- Transactional profit methods (iv &v) above.

(b) In each of the methods mentioned above, the most appropriate transfer pricing method shall be used taking into consideration:

1. The respective strengths and weaknesses of the transfer pricing method in the circumstances of the case;

2. The appropriateness of a transfer pricing method having regard to the nature of the controlled transaction determined, in particular, through an analysis of the functions performed, assets employed and risks assumed by each person that is a party to the controlled transaction;

3. The availability of reliable information needed to apply the transfer pricing method; and

4. The degree of comparability between controlled and uncontrolled transactions, including the reliability of adjustments, if any, that may be required to eliminate any differences between comparable transactions.

(c) When examining whether or not the taxable profit resulting from a taxpayer's controlled transaction or transactions is consistent with the arm's length principle, the Revenue shall base its review on the transfer pricing method used by the taxable person if such method is appropriate to the transaction.

ii. A connected taxable person may apply a transfer pricing method other than those listed in this regulation, if the person can establish that:

1. None of the listed methods can be reasonably applied to determine whether a controlled transaction is consistent with the arm's length principle;

2. The method used gives rise to a result that is consistent with that between independent persons engaging in comparable uncontrolled transactions in comparable circumstances; and

3. Reliable information needed to apply the chosen transfer pricing method exists.

(d) Where a taxpayer carries out, under the same or similar circumstances, two or more controlled transactions that are economically closely linked to one another or that form a continuum such that they cannot reliably be analysed separately, those transactions may be combined to:

- Perform the comparability analysis set out in the regulation; and

- Apply the transfer pricing methods set out in the regulation.

(e) Where the application of the most appropriate method results in a number of financial indicators for which the degree of comparability of each to the controlled transactions, and to each other, is uncertain, a statistical approach shall be used. Where such an approach is used, the inter-quartile range shall be considered to be an arm's length range.

Where the relevant financial indicator derived from a controlled transaction, or from a set of controlled transactions that are combined according to sub-regulation, falls outside the arm's length range, the Service shall adjust the taxable profit of the connected person to ensure that the relevant financial indicator equates to the most appropriate point in the arm's length range based on the facts and circumstances of the transactions.

(f) The Service is not obliged to accept the value reported for customs duty purposes when considering the income tax implications of a non-arm's length importation.

(g) Notwithstanding any other provision in these Regulations, where a person chargeable to tax in Nigeria engages directly or indirectly in a transaction with a connected person for the export or import of commodities and:

(a) in the case of export, the price that was agreed upon with the connected person is lower than the quoted price, the quoted price on the "date of transaction'', regardless of the means of transport, shall be, the sale price for the purposes of computing the taxable income of that person, unless the person provides all of the evidence needed to show that adjustments are appropriate to that quoted price to be consistent with the arm's length principle.

(b) in the case of import, the price that was agreed upon with the connected person is higher than the quoted price, the quoted price on the "date of transaction'', regardless of the means of transport, shall be, the sale price for the purposes of computing the taxable income of that person, unless the person provides all of the evidence needed to show that adjustments are appropriate to that quoted price to be consistent with the arm's length principle.

Provided that in the case of goods exported from Nigeria that are subsequently sold by a related party to an unrelated party, if the price agreed upon between that related party and the unrelated person is higher than the quoted price at the above-mentioned date, the agreed price in this case will be considered as the sale price for the purposes of computing the seller's taxable income in Nigeria unless the person provides all of the evidence needed to show that adjustments are appropriate to that sale price to be consistent with the arm's length principle.

17.7.1 Comparable uncontrolled price method (CUPM)

CUPM compares the prices charged for transactions between associated enterprises (related parties) with prices charged for similar transactions between independent enterprises (unrelated parties) in comparable circumstances. Any difference between the two prices is an indication that the transactions between the associated enterprises are not made at arm's length. For example, Ben Ltd and

Bella Ltd are members of the same group. If Ben Ltd sells a particular product to independent parties as well as to Bella Ltd under similar circumstances, the prices charged for Ben Ltd's sales to independent parties can be compared with prices charged for Ben Ltd's sales to Bella Ltd (internal comparable).

In the same vein, if an independent party Me Ltd sells to another independent party No Ltd the same product sold by Xim Ltd, the prices charged by Me Ltd can also be used as the basis for comparison (external comparable). The tax authority may reject the prices for transactions between Xim Ltd and Yaw Ltd (associated enterprises) and adopt the prices for transactions between independent enterprises for tax purposes.

On the other hand, when applying the CUPM, it is important to note that prices for the same product may differ not necessarily because of being sold to associated or independent enterprises, but because the product is not sold under similar terms and circumstances in comparable quantities and markets. It is usual to make reasonable comparability adjustments for such differences.

17.7.2 Resale price method (RPM)

RPM starts with the determination of resale price to an independent enterprise of a product purchased from an associated enterprise and a gross margin is then deducted from this resale price.

Example:

Godwill Ltd and Tent Ltd are related companies. Godwill Ltd transfers goods to Tent Ltd which Tent Ltd sells to independent parties. Under the resale price method, the arm's length price of the product acquired by Tent Ltd in a non-arm's length transaction is determined by reducing the price realized on the resale of the product by Tent Ltd to independent parties by an appropriate gross margin (resale price margin). Tent Ltd's gross margin may be determined by reference to the gross margin that Tent Ltd usually earns in comparable transactions with independent parties (internal comparable), or by reference to the gross margin earned by independent enterprises in comparable transactions (external comparable) within the industry.

17.7.2.1 Cost-plus method (CPM)

CPM relates gross profits to the cost of sales. It starts with the determination of the costs incurred by the supplier in a controlled transaction. An appropriate mark-up will be added to this cost to arrive at the correct transfer price.

Example:

D Ltd and G Ltd are related companies. D Ltd transferred 10,000 units of its product to G Ltd at N700 per unit. The direct costs incurred by D Ltd to produce the product amounted to N400 per unit. The arm's length mark-up earned by companies producing / selling similar product to independent parties is 45%. Therefore, the tax authority will recognize D Ltd's sales to G Ltd as N5,600,000 (i.e. 10,000 units x N400 x 145%) instead of N7,000,000 (i.e. 10,000 units x N700). If the method uses direct costs as in the example, then, the mark-up should cover indirect costs, overheads and profit.

17.7.3 Profit split method (PSM)

PSM starts with the determination of the combined profit that arises from a business transaction in which the associated enterprises are engaged. This profit is then shared among the associated enterprises in a manner that reflects the division of profit that would have been expected among independent enterprises. The combined profit or loss attributed to the transactions in which the associated enterprises participated is allocated to the associated enterprises in proportion to their relevant contributions to that combined operating profit or loss.

17.7.4 Transactional net margin method (TNMM)

TNMM begins with the determination of the net profit margin that an enterprise earns from transactions with an associated enterprise is compared with the net profit margin earned in comparable transactions with an independent enterprise.

A suitable net margin may be established by reference to the net margin that the enterprise earns in comparable transactions with independent enterprises (internal comparable), or by reference to the net margin earned in comparable transactions by independent enterprises (external comparable). The transactional net margin method is applied in a manner similar to the cost plus and resale price methods. On the other hand, the transactional net margin examine the net profits in relation to an appropriate base (e.g. costs, sales, assets) and not gross margin on resale or mark-up oncosts.

17.8 Intra – group services

(1) A service charge between a taxpayer and a connected person shall be considered consistent with the arm's length principle where:

(a) it is charged for a service that is actually rendered;

(b) the service provides, or when rendered was expected to provide, the recipient with economic or commercial value to enhance its commercial position;

(c) it is charged for a service that an independent person in comparable circumstances would have been willing to pay for if performed for it by an independent person, or would have performed in-house for itself; and

(d) its amount corresponds to that which would have been agreed between independent persons for comparable services in comparable circumstances.

(2) A service charge made to a person shall not be consistent with the arm's length principle where it is made by a connected person solely because of the shareholder's ownership interest in another member of the group, including for any of the following costs incurred or activities undertaken by such connected person:

(a) Costs or activities relating to the juridical structure of the parent company of the first-mentioned person, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the parent company's supervisory board;

(b) Costs or activities relating to reporting requirements of the parent company of the first-mentioned person, including the consolidation of reports; or

(c) Costs or activities related to raising funds for the acquisition of participations, unless those participations are directly or indirectly acquired by the first mentioned person and the acquisition benefits or is expected to benefit that first-mentioned person.

(3) Where it is possible to identify specific services provided by a taxpayer to a connected person, the determination whether the service charge is consistent with the arm's length principle shall be made for each specific service, subject to the provisions of sub- regulation of the transfer pricing regulation.

(4) Where services are rendered by a taxpayer jointly to various connected persons and it is not possible to identify specific services provided to each of them, the total service charge shall be allocated among the connected persons that benefit or expect to benefit from the services according to reasonable allocation criteria.

(5) For the purpose of this sub-regulation, allocation criteria shall be viewed as reasonable where they are based on a variable or variables that:

(a) Take into account the nature of the services, the circumstances under which they are provided and the benefits obtained or that were expected to be obtained by the persons for which the services are intended;

(b) Relate exclusively to uncontrolled, rather than controlled, transactions; or

(c) Are capable of being measured in a reliable manner.

17.9 Intangibles

(1) The determination of arm's length conditions for controlled transactions involving the exploitation of an intangible shall take into account the contractual arrangements and the following factors with regard to the development, enhancement, maintenance, protection and exploitation of the intangible asset, the-

(a) Functions performed by the person;

(b) Management and control of those functions;

(c) Contribution by the person of assets, including financial assets,

(d) Management and control regarding the contribution of assets, including financial assets;

(e) Risks assumed by that person; and

(f) Management and control of those risks.

(2) In cases where the contractual arrangements diverge from the factors listed under sub-regulation (1) of this regulation, regards shall be taken of those factors in determining the arm's length reward from the exploitation of the intangible.

(3) The determination of arm's length conditions for controlled transactions involving licenses, sales or other transfers of intangible property between connected persons shall take into account both the perspective of the transferor of the property and the perspective of the transferee, including in particular the pricing at which a comparable independent person would be willing to transfer the property and the value and usefulness of the intangible property to the transferee in its business.

(4) In applying the provisions of sub-regulations (3) of this regulation to a

transaction involving the license, sale or other transfer of intangible property, consideration shall be given to any special factors relevant to the comparability of the controlled and uncontrolled transactions, including

(a) The expected benefits from the intangible property;

(b) The commercial alternatives otherwise available to the acquirer or licensee derived from the intangible property;

(c) Any geographic limitations on the exercise of rights to the intangible property;

(d) The exclusive or non-exclusive character of the rights transferred; and

(e) Whether the transferee has the right to participate in further developments of the intangible property by the transfer or.

(5) Notwithstanding any other provision of these Regulations, where a person engages in any transaction with a related person that involves the transfer of rights in an intangible, other than the alienation of an intangible, the consideration payable in that transaction that is allowable for deduction for tax purposes shall not exceed 5% of the earnings before interest, tax, depreciation, amortisation and that consideration, derived from the commercial activity conducted by the person in which the rights transferred are exploited.

17.9.1 Advance pricing agreements (APA)

(1) A connected person may request that the service enter into an advance pricing agreement (APA) to establish an appropriate set of criteria for determining whether the person has complied with the arm's length principle for certain future controlled transactions undertaken by the person over a fixed period of time provided that such agreement shall be consistent with the requirements established by the regulation.

(2) A request for advance pricing agreements shall be accompanied by–

(a) A description of the activities of the taxable person to be addressed by the advance pricing agreement, including:

(i) A detailed description of the controlled transactions to be included within the scope of the advance pricing agreement;

(ii) An analysis of functions to be performed, assets to be employed and risks to be assumed by the parties to the covered transactions; and

(iii) The proposed duration of the advance pricing agreement;

(b) A proposal by the taxable person for the determination of the transfer prices for the transactions to be covered by the advance pricing agreement, including the following information:

(i) An analysis of the comparability factors;

(ii) The selection of the most appropriate transfer pricing method to the circumstances of the controlled transactions; and

(iii) The critical assumptions as to future events under which the determination is proposed;

(c) The identification of any other country or countries that the person wishes to participate in the advance pricing agreement;

(d) Any other relevant information that the Service may require to complete its analysis of the advance pricing agreement request.

(3) The Service may accept, modify or reject a request made by a connected person after taking into account documents/information that accompanied the request and the expected benefits from an advance pricing agreement.

(4) The service may in addition to accept, modify or reject a request may specify the basis for acceptance, modification or rejection of a request.

(5) The service may enter into an advance pricing agreement with a taxable person either alone or together with the competent authority of countries of the connected person.

(6) Where the service approves or modifies a proposal, it may enter into an advance pricing agreement which shall provide, among other things, a confirmation to the connected person that no transfer pricing adjustment will be made to controlled transactions covered by the Agreement where the transactions are consistent with the terms of the Agreement.

(7) An advance pricing agreement entered into under this regulation shall apply to the controlled transactions for a period not exceeding three years.

(8) The Service may terminate an advance pricing agreement by notice where:

(a) The connected person has failed to materially comply with fundamental terms of the Advance pricing agreement;

(b) There has been a material breach of one or more of the critical assumptions underlying the advance pricing agreement;

(c) There is a change in the tax law that is materially relevant to the Advance pricing agreement; or

(d) The advance pricing agreement was entered into based on a misrepresentation, mistake or omission by the connected person.

(9) A connected person may terminate an advance pricing agreement by a notice given to the Service where:

(a) There is a material change in the premise upon which the advance pricing request was made;

(b) The advance pricing agreement is no longer relevant based on significant changes to the structure of the controlled transaction; or

(c) There is a change in tax law applicable in the jurisdiction of the controlled transaction that is materially relevant to the Advance pricing agreement.

(10) The Service shall treat as confidential any trade secret or other commercially sensitive information or documentation provided to the Service in the course of negotiating or entering into an Advance pricing agreement.

(11) Termination of an advance pricing agreement takes effect, in the case of:

(a) Sub-regulation (8) (a) and (c) of this regulation, from the date specified by the Service in the notice of termination;

(b) Sub-regulation (8) (b) of this regulation, from the date the material breach occurred;

(c) Sub-regulation (8) (d) of this regulation, from the date the advance pricing agreement was entered into; and

(d) Sub-regulation (9) of this regulation, from the date specified in the notice of termination.

17.10 Documentation

Transfer Pricing documentation will include:

(a) Transfer Pricing Policy

(b) Transfer Pricing Compliance Report

(c) Transfer Pricing Returns i.e. TP declaration and disclosure forms.

17.10.1 Transfer pricing policy

A transfer pricing policy is a document that guides the conduct of related parties transaction within a group of companies. There are two types of transfer pricing policy:

(a) Group transfer pricing policy

(b) Local transfer pricing policy.

Features of a transfer pricing policy

Features of a transfer pricing policy include:

- Typically prospective in nature;
- Typically not updated unless there are significant changes in Business;
- Provides a future view of likely intercompany transactions; and
- Provides guidance on pricing of the transactions and methodology.

17.10.2 Transfer pricing compliance report

The documentation retained by a connected person shall be adequate to enable the Service verify that the controlled transaction is consistent with the arm's length principle. The burden of proof that the conditions of the controlled transactions are consistent with the arm's length principle shall be that of the taxable person and the taxable person will be regarded as satisfying this burden of proof if it provides documentation consistent with this regulation to support compliance with the arm's length principle of the taxable profits derived from its controlled transactions.

17.10.3 Transfer pricing declaration form to be submitted to FIRS

The Federal Inland Revenue Service expect all taxpayers to develop appropriate transfer pricing policy and provide relevant information to be stated in transfer pricing declaration form that contain the following:

a. Particulars of reporting company or entity;

b. Particulars of immediate parent company;

c. Particulars of directors of reporting company;

d. Particulars of major shareholders of reporting company and related parties;

e. Ownership, structure of reporting entity and related parties;

f. Particulars of subsidiaries and other connected persons;

g. Particulars of external auditors of reporting entity;

h. Particulars of tax consultant of the reporting entity;

i. Particulars of company secretary of the reporting entity;

j. Particulars of the person making the declaration; and

k. Declaration.

17.10.4 Transfer pricing disclosure form to be submitted to FIRS

The Federal Inland Revenue Service expect all taxpayers to develop appropriate transfer pricing policy and provide relevant information to be stated in transfer pricing disclosure form that contain the following:

a. Particulars of reporting company or entity;

b. Income from controlled transactions;

c. Costs of controlled transactions;

d. Summary of controlled transactions with connected persons;

e. Transfer pricing method and documentation;

f. Basic financial information for reporting entity and the group;

g. Particulars of the person making the disclosure; and

h. Declaration.

17.11 Key definition and other issues to be considered in transfer pricing

17.11.1 Controlled transactions

Controlled transaction constitutes commercial or financial transaction between connected taxable persons.

17.11.2 Connected taxable persons

Connected taxable persons include persons, individual, entities, companies, partnerships, joint ventures, trust or associations(collectively referred to as "connected taxable persons").Also includes the persons referred to in section 13, section 22 of CITA, section 15 of PPTA, section **10** of PITA, article 9 of OECD Model Tax Convention and "associated enterprise" in OECD guidelines. The following persons will be regarded as Connected Taxable Persons (i.e. related parties) within the context of the Transfer Pricing Regulation, 2018:

(a) Any entity dealing with a related party (associate, subsidiary, joint venture);

(b) A members of a local group of companies;

(c) Members of a conglomerate;

(d) Multinationals;

(e) An entity in a group located in the free zone;

(f) A group entity that has a pioneer status;

(g) Intra company profits which is taxable under different regimes e.g. tax exempt export profits;

(h) Loss making entity within a profitable group;

(i) Related parties subject to tax at different rates; and

(j) Permanent establishment.

Under the 2018 regulations, the definition of connected persons have been widened to accommodate where one person has the ability to control or influence the other person in making financial, commercial or operational decisions, or there is a third person who has the ability to control or influence both persons in making financial, commercial, or operational decisions.

17.11.3 Arm's length principle

The principle means that the conditions of a controlled transaction should not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances;

17.11.4 Permanent establishment (PE)

This mean a fixed place of business through which the business of an enterprise is wholly or partly carried on in Nigeria. It also includes any other form of taxable presence of a foreign enterprise in Nigeria.

17.11.5 Person

This includes individuals, corporation sole, entities, companies, partnerships, joint ventures, trusts or any other body of individuals.

17.11.6 Capital-rich, low-function companies

This means companies that are capitalised with a relatively high amount of equity (or equity-equivalent) capital, but which have limited capacity to carry out risk-management functions. Within multinational groups, such companies may, for example, provide debt funding to associated enterprises, or fund research and development programmes carried out by associated enterprises.

For example, where such a company funds a research and development programme conducted by an associated enterprise, but does not have the capacity to make the key decisions that manage the risks associated with the programme, it will be considered to be conducting a funding function only, and will be allocated a return on that funding on the assumption that the funding is risk-free.

17.11.7 Thin capitalisation

When a company is financed with a much greater proportion of debt than equity it is said to be thinly capitalised. In financial accounting, it is said that the company is highly geared. The tax authority is disturbed because of the excessive interest deductions particularly if the loans are obtained from connected or related parties at non-commercial rates or from foreign entities. Interest deduction reduces the profits available for tax. To circumvent the negative effects of thin capitalisation, some countries place a limit on the debt to equity ratio, while others disallow interest deductions above a certain level.

17.12 Arm's length comparability factors in transfer pricing

The Federal Inland Revenue Service (FIRS), in determining whether a transaction has been conducted at arm's length will consider the following on a comparative basis:

(a) The similarity or identical nature of the transaction to that entered into by an unconnected taxable person;
(b) The facts and circumstances of the transactions per economic relevance;
(c) The characteristics of the goods, property or services transferred or supplied;
(d) The functions undertaken by the person entering into the transaction per resources expended and the risks assured;
(e) The contractual terms of the transactions;

(f) The economic circumstances in which the transactions take place; and
(g) The business strategies pursued by the connected taxable persons to the controlled transaction.

17.13 Functional analysis in transfer pricing

The functional analysis is used for transfer pricing purposes. It analyzes the functions performed (taking into account assets used and risks assumed) by associated enterprises in a transaction. The functional analysis should focus on what each of the parties actually does and the capabilities it provides.

Also, functional analysis is an analysis of the functions performed (taking into account assets used and risks assumed) by associated enterprises in controlled transactions and by independent enterprises in comparable uncontrolled transactions.

In transactions between two independent enterprises, compensation usually will reflect the functions that each enterprise performs (taking into account assets used and risks assumed). Therefore, in delineating the controlled transaction and determining comparability between controlled and uncontrolled transactions or entities, a functional analysis is necessary. This functional analysis seeks to identify the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions.

The analysis focuses on what the parties actually do and the capabilities they provide. Such activities and capabilities will include decision-making, including decisions about business strategy and risks. For this purpose, it may be helpful to understand the structure and organisation of the MNE group and how they influence the context in which the MNE operates. In particular, it is important to understand how value is generated by the group as a whole, the interdependencies of the functions performed by the associated enterprises with the rest of the group, and the contribution that the associated enterprises make to that value creation. It will also be relevant to determine the legal rights and obligations of each of the parties in performing their functions. While one party may provide a large number of functions relative to that of the other party to the transaction, it is the economic significance of those functions in terms of their frequency, nature, and value to the respective parties to the transactions that is important.

17.14 Administration of transfer pricing regulation

The following areas are to be noted and complied with by the taxpayers and tax practitioners in Nigeria.

i. **Annual transfer pricing returns:** A connected taxable person must submit transfer pricing document annually to FIRS not later than six months after the end of each accounting year or eighteen months after the date of incorporation, whichever is earlier. Transfer Pricing disclosure and declaration forms are to be attached to the annual tax returns.

ii. **Extension of filing annual transfer pricing returns:** A connected person may apply in writing, to the Service for an extensionoftime within which to file returns and where the Service is satisfied with the reasons stated in the application made, it may grant the extension. Where the taxable person fails to meet the extended submission date granted the Service, the administrative penalty shall apply as if no extension of period was granted.

iii. **Administrative procedures:** Transfer Pricing department of FIRS shall review all Transfer Pricing documents submitted and carryout a review of transactions verifying the appropriateness of Transfer Pricing methods adopted.

iv. **Burden of proof:** transfer pricing document must demonstrate sufficient information and analysis to verify consistency of the taxable profits derived from its controlled transactions with the arm's length principle.

17.15 Dispute resolution under transfer pricing regulation

Based on the 2018 guidelines, a taxpayer who has any objection on assessment cannot approach the Decision Review Panel for a review of the assessment received from FIRS.

Taxpayers are now expected to lodge their complains with the Head, FIRS Transfer Pricing Unit (TPU) with 30 days after the date of receipt of the assessment notice.

Effective March 12, 2018 the Head of TPU has the prerogative to decide whether or not to refer the taxpayer's objection to the Decision Review Panel.

17.16 Offences and penalties:

(a) A taxable person who contravenes any of the provisions of transfer pricing regulation with respect to filing of transfer pricing returns shall be liable to a penalty as prescribed in the relevant provision of the applicable tax law – CITA, PITA, PPTA.

(b) A taxable person who fails to make disclosures of controlled transactions shall be liable to penalty of:

i. Ten million naira or one percent of the value of controlled transaction not disclosed, whichever is higher; and

ii. Ten thousand naira for every day in which the failure continues.

(c) Where a connected person makes an incorrect disclosure of transactions, an administrative penalty of ten million naira or one percent of the value of controlled transactions incorrectly disclosed, whichever is higher shall apply.

17.17 Chapter review

This chapter highlights the following:

(a) Transfer prices are significant for both taxpayers and tax administration because they impact on the income and expenses and, therefore, taxable profits of associated enterprises indifferent tax jurisdictions.

(b) OECD transfer pricing guidelines distinguish between five transfer pricing methods, namely: comparable uncontrolled price method, resale price method, cost plus method, profit split method and transactional net margin method.

(c) When a company is financed with a much greater proportion of debt than equity it is said to be thinly capitalised. In financial accounting, it is said that the company is highly geared. The tax authority is disturbed because of the excessive interest deductions particularly if the loans are obtained from connected or related parties at non-commercial rates or from foreign entities. Interest deduction reduces the profits available for tax. To circumvent the negative effects of thin capitalisation, some countries place a limit on the debt to equity ratio, while others disallow interest deductions above a certain level; and

(d) Transfer pricing is not in itself illegal or abusive, what is illegal or abusive is transfer mispricing, manipulation or abusive transfer pricing. It is therefore a compliance obligation and its practices in inter-company transactions expect to meet arm's length principles.

17.18 Worked examples

17.19.1 Open- ended questions

1. Discuss any **three** areas in which the operations of multinational companies in Nigeria could constitute difficulties in the determination of their tax liabilities to the Nigerian government;

2. In respect to transfer pricing regulations in Nigeria;

(a) Describe the following:

(i) Arm's length price

(ii) Items that constitutes controlled transactions

(b) Explain any **ten** main items that will feature in the declaration form and any **five** main items that will feature in the disclosure form to be submitted to the Federal Inland Revenue Service.

3. (a) Explain briefly a transfer pricing document.

(b) Explain any three key transfer pricing documentation.

(c) Explain key features of a transfer pricing policy

4. In relation to transfer pricing regulations in Nigeria, describe "Connected Persons" and enumerate what constitute: Connected Persons as stated in provisions of CITA, PPTA, PITA and OECD guidelines.

17.19.2 Suggested solutions to open-ended questions

1. The following are some of the areas which could constitute difficulties in the determination of tax liabilities of multinational companies' operations in Nigeria.

(a) **Different pricing of goods / services at purchase cost** in a multinational group, one member of the group in one country may supply goods or services to another member in another country. The prices charged create sales revenue for the company selling the goods or services and purchase cost for the company buying the goods or services. These will eventually affect the profits of each company which are accountable to different tax jurisdictions.

Example:

A multinational company has its subsidiary in Nigeria and head office in United States of America (USA). The Nigerian subsidiary charges low prices (below open market prices) for goods supplied to the parent company in USA. On the other hand, the parent company overcharges the Nigerian subsidiary for services rendered to the subsidiary. Consequently, the Nigerian subsidiary records low profits and pays less tax to the Nigerian Government, while the parent company declares more profits and pays more tax to the tax authority in USA. In many cases the profit is shifted to another country with a lower tax rate or no tax e.g. a tax haven.

(b) **Tax avoidance**

Transfer prices have serious tax implications and multinational transfer pricing can provide an avenue for tax avoidance.

Companies within the same group which are under different tax jurisdictions may decide to overprice or under price inter-group transactions depending on what they want to achieve.

(c) **Custom duties and tariff manipulation**

Transfer prices will also affect customs duties paid on imports and exports. For example, if the transfer prices on imports into a country are lowered, the import duties and other tariffs on the imports will equally be reduced.

(d) **Dividends manipulation**

Multinational transfer prices may also be influenced by dividend considerations. Consider a situation that Nigeria puts a restriction on the amount that a company can pay out as dividend to parties outside the country. A parent company based in Germany may decide to overprice goods and services transferred to its subsidiary in Nigeria. In that way, more funds leave the subsidiary company in Nigeria to Germany without appearing to violate the dividend restriction.

(e) **Imposition of excessive charges**

The parent company can also impose excessive charges (e.g. royalties) on its foreign subsidiaries, associates, etc in respect of the provision of intangibles such as patents, licenses, trademarks, etc and use these avenues to extract profits to a tax haven or jurisdictions with favourable tax requirement.

Where the head office of the multinational or a member of the group incurs expenses which are for the benefits of all or many members of the group. The allocation of the joint costs to members of the group will certainly affect their profits and taxes.

In a global economy where multinational enterprises (MNEs) play a prominent role, governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein. For taxpayers, it is essential to limit the risks of economic double taxation that may result from a dispute between two countries on the determination of the arm’s length remuneration for their cross-border transactions with associated enterprises as expressed by OECD.

There are provisions in the Nigerian tax laws which give the relevant tax authority power to make appropriate adjustment to counteract the reduction or would be reduction in tax liability where transactions between connected persons or related parties are not made at arm's length and the tax authority feels that such transactions are made to reduce the tax liability.

2 (a) i. Arm's length price is the price charged for the transfer of goods, services or intangible property between connected taxable persons which corresponds to the price that would have been charged by independent persons under similar circumstance.

ii. Items that constitute controlled transactions include:

- Sale and purchase of goods and services;
- Sale, purchase or lease of tangible assets;
- Purchase, licence of intangibles;
- Provision of services;
- Lending and/or borrowing;
- Manufacturing arrangement; and
- Any other controlled transaction which may affect statement of comprehensive income such as management and technical services, etc.

(b) **Declaration form contents are as follows:**

i. Particulars of Reporting Company or Entity;

ii. Particulars of immediate Parent Company;

iii. Particulars of Directors of Reporting Company;

iv. Particulars of major Shareholders of Reporting Company and Related Parties;

v. Ownership, Structure of Reporting Entity and Related Parties;

vi. Particulars of Subsidiaries and other Connected Persons;

vii. Particulars of External Auditors of Reporting Entity;

viii. Particulars of Tax Consultant of the Reporting Entity;

ix. Particulars of Company Secretary of the Reporting Entity; and

x. Particulars of the person making the declaration.

Disclosure for contents are as follows:

i. Particulars of Reporting Company or Entity;

ii. Income from controlled transactions;

iii. Costs of controlled transactions;

iv. Summary of controlled transactions with connected persons;

v. Transfer pricing method and documentation;

vi. Basic financial information for reporting entity and the group; and

vii. Particulars of the person making the disclosure.

3. (a) A transfer pricing policy is a document that guides the conduct of related parties' transaction within a group of companies. There are two types of transfer pricing policy:

(i) Group transfer pricing policy; and

(ii) Local Transfer Pricing Policy.

(b) Transfer Pricing documentations are as follows:

(i) Transfer pricing policy;

(ii) Transfer pricing compliance report;

(iii) Transfer Pricing Returns i.e. transfer pricing declaration and disclosure form

(c) Key features of a transfer pricing policy are as follows:

(i) Typically prospective in nature;

(ii) Typically not updated unless there are significant changes in business;

(iii) Provides a future view of likely intercompany transactions; and

(iv) Provides guidance on pricing of the transactions and methodology.

4. Connected taxable persons include persons, individual, entities, companies, partnerships, join ventures, trust or associations (collectively referred to as "Connected Taxable Persons"). Also includes the persons referred to in section 13, section 22 of CITA, section 15 of PPTA, section 17 of PITA, article 9 of OECD Model Tax Convention and "associated enterprise" in OECD guidelines.

   The following persons will be regarded as connected taxable persons (i.e. related parties) within the context of the Transfer Pricing Regulation2018.

   (a) Any entity dealing with a related party (associate, subsidiary, joint venture).

   (b) A members of a local group of companies.

   (c) Members of a conglomerate.

   (d) Multinationals.

   (e) An entity in a group located in the free zone.

   (f) A group entity has a pioneer status.

   (g) Intra company profits is taxable under different regimes e.g. tax exempt export profits.

   (h) Loss making entity within a profit able group.

   (i) Related parties subject to tax at different rates.

   (j) Permanent establishment.

Professional level

Advanced Taxation

18

Base erosion and profit shifting

Contents

18.5 Actions against base erosion and profit shifting (BEPS) by OECD
18.6 Country by Country Reporting Regulations FIRS specific
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Base erosion and profit shifting

18.0 Purpose

After studying this chapter, readers should be able to:

(a) Distinguish between base erosion and profit shifting;

(b) Know the primary players in base erosion and profit shifting;

(c) Know base erosion and profit shifting techniques; and

(d) Understand actions against base erosion and profit shifting.

18.1 Introduction

Base erosion

Base erosion is the use of financial measures and tax planning to reduce the size of the company's taxable profits in a country. It is often achieved by structuring income to have more favourable tax treatment or by finding ways to write off certain expenditure against taxable income. This has the effect of reducing a company's tax payment below what it would otherwise has been.

Profit shifting

Profit shifting involves making payment to other group companies in order to move profit from high–tax jurisdictions to lower–tax regimes. This serves to increase the overall profits available to the group shareholders. Often, these intra-group payments take the form of royalties and interest payments, as these expenses can be deducted from pre- tax profits. Another issue with these types of payment is that some jurisdictions have lower tax rates on them when received as income by other persons.

Essentially, base erosion and profit shifting (BEPS) refers to corporate tax planning strategies used by multinationals to "shift" profits from higher–tax jurisdictions to lower–tax jurisdictions, thus "eroding" the "tax– base" of the higher–tax jurisdictions.

18.2 Primary players in base erosion and profit shifting

Multinational group of companies are best placed to take advantage of these tax avoidance tactics due to the following factors:

- Their international operations provide a ready-made network of companies through which group funds can flow;
- They have capital to set up and maintain entities used for tax reduction purposes; and

- Their income tends to be large enough to support the cost of (i) taking advice on tax restructuring (ii) putting in place and maintaining the recommended tax structure and (iii) updating the structure with countries' changes in tax law.

18.3 Base erosion and profit shifting techniques

Base erosion and profit shifting could be achieved using any or combination of the following techniques:

a. **Trademark and technology licensing/transfer pricing** – Managing the group's trademark, design and patent through an entity that applies a lower tax rate to intellectual property, then charging group companies royalties on the use of the brand;

b. **Thin capitalisation** – By setting up subsidiaries with minimal share capital, group can use a financing arm to fund the new company's operation with debt. This large debt attracts interest, which has different treatment in some jurisdiction and can therefore reduce the group tax payment if structured correctly;

c. **Hybrid mismatch arrangements** – Different tax rules between countries can sometimes give rise to unintended effects like "double non-taxation" which can be exploited by businesses to reduce their tax burden. This primarily applies to national treatment of certain instruments in such a way that they are treated in the paying country as tax deductible debt, but seen in the receiving country as tax exempt income; and

d. **Putting assets into entity without substance** – Some countries introduce preferential tax regimes as a way to compete for business. However, this is only useful if the business with substance begin to locate themselves in the country, otherwise, this form of tax competition simply erodes the tax base of the country where the activity takes place.

Contributory factors to base erosion and profit shifting

a. **Digital economy:** Digital economy means that services can be delivered from anywhere while generating values and making sales everywhere. Taxation of digital transactions has become a herculean tax for tax authorities all over the world because digital transactions require little or no physical presence of the parties to which income accrues, in the jurisdiction of the consumer. It is usually challenging to determine whether tax on cross border transactions should be paid to the jurisdiction where value is created or consumed.

b. **International cooperation:** Since tax is levied domestically, it is difficult to determine what should be taxed where, and in what manner, without some form of international cooperation and exchange of information.

18.4 Actions against base erosion and profit shifting

Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS.

The organisation for Economic Cooperation and Development (OECD)'s base erosion and profit shifting (BEPS) initiative seeks to close gaps in international taxation for companies that allegedly avoid taxation or reduce tax burden in their home country by engaging in tax inversions (moving operations) or by migrating intangibles to lower tax jurisdictions.

The OECD has issued 15 action items to address the main areas where they feel companies have been most aggressively accomplishing this shifting of profit. The action items are as follows:

i. **Address the tax challenges of the digital economy** Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of value a tax or goods and services tax with respect to the cross-border supply of digital goods and services.

ii. **Neutralise the effects of hybrid mismatch arrangements** Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i)changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payer; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and

(v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be coordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.

iii. **Strengthen controlled foreign company (CFC) rules** Develop recommendations regarding the design of controlled foreign company rules. This work will be coordinated with other work as necessary.

iv. **Limit base erosion via interest deductions and other financial payments**
Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example

through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be coordinated with the work on hybrids and CFC rules.

v. **Counter harmful tax practices more effectively, taking into account transparency and substance**

Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.

vi. **Prevent treaty abuse**

Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids.

vii. **Prevent the artificial avoidance of PE status**

Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.

viii. **Assure that transfer pricing outcomes are in line with value creation– intangibles**

Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and updating the guidance on cost contribution arrangements.

ix. **Assure that transfer pricing outcomes are in line with value creation – risk and capital**

Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be coordinated with the work on interest expense deductions and other financial payments.

x. **Assure that transfer pricing outcomes are in line with value creation – other high risk transactions**
Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.

xi. **Establish methodologies to collect and analyse data on BEPS and the actions to address it**
Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.

xii. **Require taxpayers to disclose their aggressive tax planning arrangements**
Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be coordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.

xiii. **Re-examine transfer pricing documentation**
Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that multinational enterprises (MNE's) provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template

xiv. **Make dispute resolution mechanisms more effective** Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under Mutual Agreement Procedure (MAP), including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.

xv. **Develop a multilateral instrument**
Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.

18.6 Country by country reporting regulations FIRS specific

18.6.1 Provision of country by country reporting (CbCr)

The Federal Inland Revenue Service (FIRS) released the Income Tax (Country by Country Reporting) Regulations, 2018 (the Regulations) which was published in an official gazette dated 8 January 2018.

The objectives of the regulations are to provide tax authorities with information about Multinational Enterprises' (MNEs) global activities, profits, and taxes to better assess international tax avoidance risks; improve transparency in the tax practices of the MNEs; and prevent tax evasion or avoidance through base erosion and profit shifting.

Some of the key provisions of the regulations include the following:

- Each ultimate parent entity (UPE) of an MNE Group having consolidated group revenue of N160 billion or above is required to file a Country-by-Country (CbyC) report in a specified format with the FIRS on an annual basis, provided that such entity is resident in Nigeria for tax purposes. The CbyC report should be filed not later than 12 months after the last day of the reporting accounting year of the MNE Group;
- A constituent entity which is not the UPE of an MNE Group that meets certain conditions will also be required to file a CbyC report with the FIRS within the time specified;
- A constituent entity will not be required to file a CbyC report if same has been filed through a surrogate parent entity in the format specified in the regulations;

- Failure to submit the CbyC report within the time stipulated would attract a penalty of ₦10,000,000 in the first instance and N1,000,000 for every month in which the default continues;

- Any constituent entity that is resident in Nigeria for tax purposes should notify the FIRS whether it is a UPE or surrogate parent entity. Where it is neither of the two, it should notify the FIRS of the identity and tax residence of the reporting entity not later than the last day of the reporting accounting year of the MNE Group. Where a constituent entity fails to provide such notification, such entity will be liable to a penalty of ₦5,000,000 in the first instance and ₦10,000 for every day in which the default continues.

18.6.2 Applications of country by country reporting (CbCr)

The Federal Inland Revenue Service (FIRS) issued its guidelines for Country-by-country (CbC) reporting in Nigeria ("the Guidelines") to supplement the Income Tax (CbC Reporting) Regulations, 2018 ("the CbC Regulations"). The guidelines are intended to provide guidance to the general public, especially Multinational Enterprises (MNEs) operating in Nigeria, on the procedure for completing and filing CbC reports.

Part I of the guidelines provides a general background to the Organisation for Economic Cooperation and Development (OECD)'s base erosion and profit shifting project which introduced the CbC reporting requirement for MNEs. It explicitly states that the OECD (2018) Guidance on the implementation of CbC reporting – BEPS Action 13 as may be updated from time to time ("OECD Guidance") will be relied upon for any clarification or explanation that is not covered in the guidelines.

It further states that the guidelines will be applied in a manner consistent with the following documents, amongst others:

The Income Tax (Transfer Pricing) Regulations 2018 (which is expected to be published by the FIRS anytime soon)

- the newly issued FIRS Guidelines for the Appropriate Use of Information contained in CbC reports, which essentially set out the FIRS' policy on how to avoid abuse of information contained in CbC reports
- The OECD Guidance.

Parts II and III of the Guidelines provide definitions of terms used in the annual CbC reporting template, and instructions on the period to be covered by the template, the data to be used in populating it, and how each table in the CbCR template should be completed. These instructions are the same as those provided in the OECD Guidance.

Part IV of the guidelines stipulates how branches, permanent establishments, investment funds, partnerships and other entities would be treated for CbC reporting purposes. Of particular note in this part is the guidance that the consolidation rule in the International Financial Reporting Standards be adopted as the accounting basis for determining the existence and membership of a group which is required to file a CbC report in Nigeria.

The final part of the guidelines focuses on CbC filing obligations. Essentially, it specifies the CbC notification form with which every resident member of an MNE Group is required to submit yearly to the FIRS pursuant to Regulation 6 of the CbC regulations. It also clarifies issues bordering on CbC reporting threshold, determination of consolidated revenue, and merger, acquisition and demerger arrangements.

The release of the country by country regulations which is pursuant to OECD actions against base erosion and profit shifting (BEPS) project will usher the Nigeria transfer pricing (TP) regime into a post BEPS era associated with a significant level of transparency in the global tax affairs of MNEs doing business in Nigeria. Thus, taxpayers are likely to be subjected to increased scrutiny through audits and investigations that may result in significant rise in TP disputes. Therefore, MNEs in Nigeria should take proactive steps to mitigate transfer pricing (TP) risk exposures by conducting holistic review of their TP practices.

18.7 Chapter review

This chapter defines base erosion and profit shifting. It also identifies the major users of these tax avoidance strategies and techniques usually adopted. Besides, the chapter identifies some of the actions against base erosion and profit shifting as suggested by OECD.

Readers must have learnt the provisions of the country by country regulations issued by the Federal Inland Revenue Service.

18.8 Worked examples

18.8.1 Open-ended questions

(1) Base erosion and profit shifting are advanced tax avoidance strategies usually adopted by multinational enterprises (MNEs). You are required to discuss any four (4) techniques that could be used to achieve these tax avoidance strategies by MNEs.

(2) The Organization for Economic Cooperation and Development (OECD) in its effort to address the problem associated with base erosion and profit shifting has issued paper on various actions against the menace of base erosion and profit shifting.

Required :

(a) Define base erosion

(b) Define profit shifting

(c) Discuss five (5) actions against base erosion and profit shifting as suggested by OECD

18.8.2 Suggested Solutions to open-ended questions

(1) The following are the techniques usually adopted by the multinational enterprises (MNEs) to achieve base erosion and profit shifting tax avoidance strategies:

a. **Trademark and technology licensing/transfer pricing** – Managing the group's trademark, design and patent through an entity that applies a lower tax rate to intellectual property, then charging group companies royalties on the use of the brand;

b. **Thin capitalisation** – By setting up subsidiaries with minimal share capital, group can use a financing arm to fund the new company's operation with debt. This large debt attracts interest, which has different treatment in some jurisdiction and can therefore reduce the group tax payment if structured correctly;

c. **Hybrid mismatch arrangements** – Different tax rules between countries can sometimes give rise to unintended effects like "double non-taxation" which can be exploited by businesses to reduce their tax burden. This primarily applies to national treatment of certain instruments in such a way that they are treated in the paying country as tax deductible debt, but seen in the receiving country as tax exempt income; and

d. **Putting assets into entity without substance** – Some countries introduce preferential tax regimes as a way to compete for business. However, this is only useful if the business with substance begin to locate themselves in the country, otherwise, this form of tax competition simply erodes the tax base of the country where the activity take place.

(2) (a) **Base erosion**

Base erosion is the use of financial measures and tax planning to reduce the size of the company's taxable profits in a country. It is often achieved by structuring income to have more favourable tax treatment or by finding ways to write off certain expenditure against taxable income. This has the effect of reducing a company's tax payment below what is would otherwise be expected to pay.

(b) **Profit shifting**

Profit shifting involves making payment to other group companies in order to move profit from high–tax jurisdictions to lower–tax regimes. This serves to increase the overall profits available to the group shareholders. Often, this intra-group payments take the form of royalties and interest payments, as these expenses can be deducted from pre-tax profits. Anotherissue with these types of payment is that some jurisdictions have lower tax rates on them when received as income by other persons.

(c) The following actions have been put in place by the Organization for Economic Cooperation and Development (OECD) to address the problem of base erosion and profit shifting:

(i) **Address the tax challenges of the digital economy** Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of value added tax/goods and services tax with respect to the cross-border supply of digital goods and services.

(ii) **Neutralise the effects of hybrid mismatch arrangements**
Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long- term deferral) of hybrid instruments and entities. This may include:

(i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly;

(ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payer;

(iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules)

(iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and where necessary, guidance on coordinationor tie- breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be coordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.

(iii) **Limit base erosion via interest deductions and other financial payments**
Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be coordinated with the work on hybrids and CFC rules.

(iv) **Counter harmful tax practices more effectively, taking into account transparency and substance**
Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate

preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.

(v) **Prevent treaty abuse**

Develop model treaty provisions and recom design of domestic rules to prevent the gra inappropriate circumstances. Work will also treaties are not intended to be used to gen and to identify the tax policy considerations should consider before deciding to enter into country. The work will be coordinated with th

19

Regional integration and trade blocs

Contents

Regional integration and trade blocs

19.0 Purpose

After studying this chapter, readers should be able to:

(a) distinguish between regional integration and trade blocs;

(b) understand the objectives of regional integration;

(c) know the types of regional economic integration;

(d) know the benefits of regional integration and trade blocs; and

(e) know the disadvantages of regional integration and trade blocs.

19.1 Introduction

Regional integration
This is a process in which neighbouring states enter into an agreement in order to upgrade cooperation through common institutions and rules. The objectives of the agreement could range from economic to political to environmental, although it has typically taken the form of a political economy initiative where commercial interests are the focus for achieving broader socio-political and security objectives, as defined by national governments. Regional integration has been organised either via supranational institutional structures or through inter - governmental decision-making, or a combination of both.

Past efforts at regional integration have often focused on removing barriers to free trade in the region, increasing the free movement of people, labour, goods, and capital across national borders, reducing the possibility of regional armed conflict (for example, through confidence and security-building measures), and adopting cohesive regional stances on policy issues, such as the environment, climate change and migration.

Trade blocs

A trade bloc is basically a free-trade zone, or near-free-trade zone, formed by one or more tax, tariff, and trade agreements between two or more countries. Some trading blocs have resulted in agreements that have been more substantive than others in creating economic cooperation. Of course, there are pros and cons for creating regional agreements. In the past decade, there has been an increase in the trading blocs with more than one hundred agreements in place and more in discussion.

19.2 Objectives of regional integration

Regional integration is the joining of individual states within a region into a larger whole. The degree of integration depends upon the willingness and commitment of independent sovereign states to share theirsovereignty.Regionalintegrationinitiativesshouldfulfillatleastthe following eight important objectives:

i. the strengthening of trade integration in the region;

ii. the creation of an appropriate enabling environment for private sector development;

iii. the development of infrastructure programmes in support of economic growth and regional integration;

iv. the development of strong public sector institutions and good governance;

v. the reduction of social exclusion and the development of an inclusive civil society

vi. contribution to peace and security in the region;

vii. the building of environment programmes at the regional level; and

viii. The strengthening of the region's interaction with other regions of the world.

19.3 Regional economic integration

Regional economic integration has enabled countries to focus on issues that are relevant to their stage of development as well as encourage trade between neighbours. The following are four main types of regional economic integration:

1. **Free trade area**
   This is the most basic form of economic cooperation. Member countries remove all barriers to trade between themselves but are free to independently determine trade policies with non - member nations. An example is the North American Free Trade Agreement (NAFTA);

2. **Customs union**.

   This type provides for economic cooperation as in a free-trade zone. Barriers to trade are removed between member countries. The primary difference from the free trade area is that members agree to treat trade with non - member countries in a similar manner. The Gulf Cooperation Council (GCC)for the Arab States of the Gulf and the Economic Community of West African States (ECOWAS) are examples;

3. **Common market.**
This type allows for the creation of economically integrated markets between member countries. Trade barriers are removed, as are any restrictions on the movement of labour and capital between member countries. Like customs unions, there is a common trade policy for trade with non - member nations. The primary advantage to workers is that they no longer need a visa or work permit to work in another member country of a common market. An example is the Common Market for Eastern and Southern Africa (COMESA); and

4. **Economic union.**
This type is created when countries enter into an economic agreement to remove barriers to trade and adopt common economic policies. An example is the European Union (EU).

19.4 Economic Community of West Africa State (ECOWAS)

19.4.1 Formation

Economic Community of West Africa State (ECOWAS) is a regional body created on 25th May, 1975 during its first conference in Lagos, where it treaty was signed. The idea of having a united West African body was first proposed by the then Nigerian head of state, Yakubu Gowon. His idea was to collectively achieve a self-sufficiency through integration of the sixteen West African countries into an economic block with a single market controlled around an economic and monetary union. The community started with a5 members. Later on Cape Verde joined in 1976, but Mutituana withdrew it membership in December 2000. At the moment, the commission has 15 members namely Benin, Ghana, Benin, Nigeria, Sierra Leone ,Liberia, Guinea Bissau, Mali, Senegal, Togo, Gambia, Cape Verde and Burkina Faso. The main objective of ECOWAS is to promote co-operation and integration in order to create an economic and monetary union for encouraging economic growth and development in West Africa, through:

- The suppression of customs duties and equivalent taxes;
- the establishment of a common external tariff;
- the harmonization of economic and financial policies; and
- the creation of a monetary zone.

19.4.2 Fiscal policy

The economic landscape of most West African countries is marked by structural fiscal deficits, which coexist alongside rising public debt, resulting from a dependence on external aid. The latter being debt, disguised as financial assistance. This trend has always raised doubts amongst economists and development practitioners about the sustainability of public financing and the capability of West African economies to grow in the medium term, despite optimism on the matter. The situation is particularly worrying, given the underlying fiscal challenges, due to the importance of the informal sector in the region, persistent tax evasion, weak tax institutions and poorly coordinated and harmonized regional tax and fiscal policy rules.

West Africa has also been growing its Gross Domestic Products (GDP) but unfortunately, in many cases, those nominal increases have meant little to the wellbeing and the livelihoods of its citizens. Most people continue to live below poverty line and soaring unemployment rates have revived the debate on the importance of fiscal policy in the context of non-existent endogenous monetary policies. Considering the importance of sound public policy in contemporary developing economies, understanding fiscal policy as an important determinant of the cyclical dynamics of macroeconomic aggregates can make a valuable contribution to the design of stabilization and structural economic transformation agenda within the West African Region. Given the importance of regional dynamics of integration that support economic transformation, there is plenty analysis on fiscal stimulus in developed countries, while less research and analysis is dedicated to the cyclical behavior of fiscal policy rules in the context of regional economic integration within the ECOWAS states.

ECOWAS has developed macroeconomic convergence criteria for member states including fiscal policy and recently adopted and implemented the common external tariff (CET). However, it has no internal coordinated common fiscal rules to support economic integration efforts and to mobilize adequate domestic resources to finance its regional and national development plans. In addition, weak tax systems combined with high and inefficient public spending are marked by institutional corruption, and have substantially contributed to increasing public debt. In the 2000s, most member countries benefited from the Highly Indebted Poor Countries (HIPC) initiative but despite this, public debt continues to increase in the region and remains a big challenge to macroeconomic stability, sustainable inclusive economic growth and poverty alleviation. Moreover, divisive tax and fiscal policy negatively affects the development of regional economic projects, stifling local private sector and employment.

19.4.3 ECOWAS common external tariffs

Common external tariff (CET) is a key feature of a Customs Union. CET is the application of the same customs duties, import quotas and preferences by a group of countries in a customs union. The said import duties, quotas and preferences are applicable to good entering the region of the customs union irrespective of the country of first entry of the goods.

The ECOWAS Common External Tariff is one of the principal instruments for harmonizing ECOWAS member states and strengthening its Common Market. In order to establish an economic union, the community is to ensure, in stages, among other means, the establishment of a common market through “the adoption of a common external tariff and a common trade policy vis-à-vis third countries…” To this end, the ECOWAS Authority of Heads of State and Government established an ECOWAS Customs necessitating the formulation of a common external tariff with a common nomenclature so that customs procedures are transparent, readily followed and delays at borders decreased, is a key stone in achieving this union. In January 2006 in Niamey, The Authority of Heads of State and Government of ECOWAS adopted a decision establishing the ECOWAS-CET which draws on the basic UEMOA CET composed of four tariff bands, or rates of customs duty. Below is a table depicting the four tariff bands:

Category	Percentage of duties	Goods description

0	0%	Essential social goods
1	5%	Goods of primary necessity, raw materials and specific inputs.
2	10%	Intermediate goods.
3	20%	Final consumption goods.

The ECOWAS tariff nomenclature has been migrated from 2007 to the 2012 version (HS2012) introduced by the World Customs Organization (WCO).

On 25th October 2013, ECOWAS member states adopted the ECOWAS Common External Tariff with the 5-tariff band structure below:

Category	Percentage of duties	Goods description
0	0	Essential social goods.
1	5%	Goods of primary necessity, raw goods and capital goods.
2	10%	Intermediate goods and inputs
3	20%	Final consumption goods or finished goods
4	35%	Specific goods for economic development

The CET has the following accompanying trade defense measures namely:

1. Safeguard measures;
2. Anti-Dumping Measures;
3. Anti-Subsidy and countervailing Measures; and
4. Supplementary protection Measures.

19.4.4 Regional trading blocs in Africa in comparison to:

European Union (EU)

European Union (EU), international organization comprising 27 European countries and governing common economic, social, and security policies. The EU's members are Austria, Belgium, Bulgaria, Croatia, Cyprus,the CzechRepublic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, theNetherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain,and Sweden. The United Kingdom, which had been a founding member of the EU, left the organization in 2020.

The goals of the European Union are:

- ✓ promote peace, its values and the well-being of its citizens;
- ✓ offer freedom, security and justice without internal borders;

- ✓ sustainable development based on balanced economic growth and price stability, a highly competitive market economy with full employment and social progress, and environmental protection;
- ✓ combat social exclusion and discrimination;
- ✓ promote scientific and technological progress;
- ✓ enhance economic, social and territorial cohesion and solidarity among EU countries;
- ✓ respect its rich cultural and linguistic diversity; and
- ✓ establish an economic and monetary union whose currency is the euro.

North American Free Trade Agreement (NAFTA)

In January 1994, the United States, Mexico and Canada entered into the North American Free Trade Agreement (NAFTA), creating the largest free trade area and richest market in the world.

The North American Free Trade Agreement (NAFTA) was implemented to promote trade between the U.S., Canada, and Mexico.

The following are some of the key goals of NAFTA:

- More free trade resulting in greater choices in goods and services;
- Lower prices and improved quality products;
- Stronger health and safety standards;
- Improved economic stability in the U.S. marketplace; and
- A marketplace that is increasingly driven more by supply and demand than by barriers to commerce.

19.5 Benefits of regional economic integration and tradeblocs

The benefits derivable from regional economic integration and trade blocs agreements include the followings:

- **Trade creation:** These agreements create more opportunities for countries to trade with one another by removing the barriers to trade and investment. Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries. Studies indicate that regional economic integration significantly contributes to the relatively high growth rates in the less-developed countries.

- **Employment opportunities:** By removing restrictions on labour movement, economic integration can help expand job opportunities.

- **Consensus and cooperation:** Member nations may find it easier to agree with smaller numbers of countries. Regional understanding and similarities may also facilitate closer politicalcooperation.

- **Impetus for private sector planning and investment:** Regional economic integration can serve a useful economic purpose beyond the direct gains from trade liberalisation, by reducing uncertainties and improving credibility and thus making it easier for the private sector to plan and invest. Indeed, reducing uncertainty may be vital for realizing gains from liberalisation. Whether economies benefit from a particular regional trade agreement depends on the scope and coverage of its provisions, the nature of the enforcement mechanism and the circumstances in which the agreement can be modified.

19.6 Disadvantages of regional economic integration and trade blocs

Creation of regional economic integration and trade blocs agreements may result in the following disadvantages:

- **Trade diversion:** The flip side to trade creation is trade diversion. Member countries may trade more with each other than with nonmember nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country. In this sense, inefficient companies can be protected inadvertently with the bloc agreement acting as a trade barrier. In essence, regional agreements have formed new trade barriers with countries outside of the tradingbloc.

- **Employment shifts and reductions:** Countries may move production to cheaper labour markets in member countries. Similarly, workers may move to gain access to better jobs and wages. Sudden shifts in employment can distort the resources of member countries.

- **Loss of national sovereignty:** With each new round of discussions and agreements within a regional bloc, nations may find that they have to give up more of their political and economicrights.

19.7 Chapter review

This chapter distinguishes between regional integration and trade blocs. The chapter also dwells on objectives of regional integration andvarious forms of regional economic integration and trade blocs. The pros and cons of regional economic integration and trade blocs were also discussed in this chapter.

19.8 Worked examples

19.8.1 Open-ended questions

(1) Larry Limited based in Lagos, is a manufacturing company that has been producing household utensils successfully for several years. The company is planning to enter the international market but the management team has little or no information in respect of regional economic integration and trade blocs around the world.

The Managing Director of the company has just engaged your professional accounting firm to provide advice on some salient issues in this respect.

Required:
As the officer in charge of international tax matters in the accounting firm, you are to present a report to your principal partner, for his review before sending it to the client, covering the following areas:

a. Distinction between regional integration and trade blocs

b. Objectives of regional integration

c. Common market and economic union as major types of regional economic integration

d. Benefits of regional economic integration and trade blocs

e. Disadvantages of regional economic integration and trade blocs

(2) Regional economic integration and trade blocs have often focused on removing barriers to free trade in the region, increasing the free movement of people, labour, goods, and capital across national borders, reducing the possibility of regional armed conflict and host of others

(3)

Required:

a. Define regionalintegration

b. Define tradeblocs

c. Discuss the pros and cons of regional economic integration and trade blocsagreements

19.8.2 Suggested solutions to open-ended questions

(1)

Internal memo

Date: September 15, 2020

From: Desk Officer, International Tax Matters

To: The Principal Partner

Re: Report on Request from Larry Limited about Regional Integration and Trade Blocs

I refer to the request of the above named client in respect of regional integration and trade blocs. A summary of the findings is hereby stated below:

a. Distinction between Regional Integration and Trade blocs

Regional integration

This is a process in which neighbouring states enter into an agreement in order to upgrade cooperation through common institutions and rules. The objectives of the agreement could range from economic to political to environmental, although it has typically taken the form of a political economy initiative where commercial interests are the focus for achieving broader socio-political and security objectives, as defined by national governments. Regional integration has been organised either via supranational institutional structures or through inter-governmental decision-making, or a combination of both.

Past efforts at regional integration have often focused on removing barriers to free trade in the region, increasing the free movement of people, labour, goods, and capital across national borders, reducing the possibility of regional armed conflict for example, through confidence and security building measures, and adopting cohesive regional stances on policy issues, such as the environment, climate change and migration. For example, North American Free Trade Agreement, Asian Pacific Economic Cooperation Forum, etc.

Trade blocs

A trade bloc is basically a free-trade zone or near-free-trade zone formed by one or more tax, tariff, and trade agreements among two or more countries.

Some trading blocs have resulted in agreements that have been more substantive than others in creating economic cooperation.

In the past decade, there has been an increase in these trading blocs with more than one hundred agreements in place and more in the pipeline for example, The European Union (EU), Economic Community of West African State (ECOWAS), etc.

b. **Objectives of regional integration**

Regional integration is the joining of individual states within a region into a larger whole. The degree of integration depends upon the willingness and commitment of independent sovereign states to share their sovereignty.

Regional integration initiatives should fulfil at least the following eight important objectives:

i. Strengthening of trade integration in the region;

ii. the creation of an appropriate enabling environment for private sector development;

iii. Development of infrastructure programmes in support of economic growth and regional integration;

iv. Development of strong public sector institutions and good governance;

v. Reduction of social exclusion and the development of an inclusive civil society;

vi. Contribution to peace and security in the region;

vii. Building of environment programmes at the regional level; and

viii. Strengthening of the region‟s interaction with other regions of the world.

c. **Common market and economic union as major types of regional economic integration**

Common market and economic union

Regional economic integration has enabled countries to focus on issues that are relevant to their stage of development as well as encourage trade between neighbours. Common market and Economic union are types of regional economic integration.

Common market

Common market allows for the creation of economically integrated markets between member countries. Trade barriers are removed, as well as any restrictions on the movement of labour and capital between member countries. Like customs unions, there is a common trade policy for trade with nonmember nations. The primary advantage to workers, is that they no longer need a visa or work permit to work in another member country of a common market. Examples are the common market for Eastern and Southern Africa (COMESA), West African Common Market (WACM), etc.

Economic union

Economic union is a type of trade blocs that allows products, services and workers to cross borders freely. The union is aimed at eliminating internal trade barriers within member countries, with the goal of economically benefiting all the member countries. Economic union requires the integration of monetary and fiscal policies so that member countries coordinate policies, taxation and government spending relating to their agreement. They also use common currency and fixed exchange rate.

d. **Benefits of regional integration and trade blocs**

The advantages or benefits derivable from regional economic integration and trade blocs agreements include the following:

i. Trade creation - These agreements create more opportunities for countries to trade with one another by removing the barriers to trade and investment. Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries. Studies indicate that regional economic integration significantly contributes to the relatively high growth rates in the less-developed countries;

ii. Employment opportunities - By removing restrictions on labour movement, economic integration can help expand job opportunities;

iii. Consensus and cooperation - Member nations may find it easier to agree with smaller numbers of countries. Regional understanding and similarities may also facilitate closer political cooperation;

iv. Impetus for private sector planning and investment - Regional economic integration can serve a useful economic purpose beyond the direct gains from trade liberalisation, by reducing uncertainties and improving credibility and thus making it easier for the private sector to plan and invest. Indeed, reducing uncertainty may be vital for realising gains from liberalisation. Whether or not economic benefits from a particular regional trade agreement depends on the scope and coverage of its provisions, the nature of the enforcement mechanism and the circumstances in which the agreement can be modified; and

v. Other non-economic benefits - Regional economic integration may allow a member country to reap other non-economic benefits, such as peace and security.

e **Disadvantages of regional integration and trade blocs**

Creation of regional economic integration and trade blocs may lead to any of the following disadvantages:

i. Trade diversion - The flip side to trade creation is trade diversion. Member countries may trade more with each other than non-member nations. This may mean increasing trade with a less efficient or more expensive producer simply because it is a member nation. In this sense, inefficient companies can be protected inadvertently with the trade bloc agreements, acting as a trade barrier. In essence, regional agreements have formed new trade barrier with countries outside of the trading bloc;

ii. Investment diversion - One of the problems facing many smaller economies is lack of foreign investment. Investment diversion is a potential economic disadvantage of regional economic integration program. Foreign investors from non-member countries may see a member country as less attractive place to invest due to higher burden of tariffs and regulations against nonmember states;

iii . Employment shifts and reduction - Countries and companies in one member nation may move production to another member country with a cheaper labour market. Also, workers may move to gain access to better jobs and wages. Sudden shifts in employments can distort the resources of member countries; and

i. Loss of national sovereignty - With each new round of discussions and agreements within a regional bloc, nations may discover that they have given up their political and economic rights.

Regional integration and trade blocs are forms of trade barriers with countries which are not members of the trading bloc.

The above is for your perusal and further action.

Regards,

Clement Nwafo

2. (a) Regional integration is a process in which neighboring states enter into an agreement in order to upgrade cooperation through common institutions and rules. Theobjectivesof the agreement could range from economic to political to environmental, although it has typically taken the form of a political economy initiative where commercial interests are the focus for achieving broader socio- political and security objectives, as defined by national governments. Regional integration has been organized either via supranational institutional structures orthrough intergovernmental decision-making, or a combination of both.

(b) A trade bloc is basically a free-trade zone, or near-free-trade zone, formed by one or more tax, tariff, and trade agreements between two or more countries. Some trading blocs have resulted in agreements thathavebeen more substantive than others in creating economic cooperation. Of course, there are pros and cons for creating regional agreements. In the past decade, there has been an increase in these trading blocs with more than one hundred agreements in place and more in discussion.

(c) i. The benefits derivable from regional economicintegration and trade blocs agreements include the followings:

- **Trade creation:** These agreements create more opportunities for countries to trade with one another by removing the barriers to trade and investment. Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries. Studies indicate that regional economic integration significantly contributes to the relatively high growth rates in the less-developedcountries;

- **Employment opportunities:** By removing restrictions on labour movement, economicintegration can help expand jobopportunities;

- **Consensus and cooperation:** Member nations may find it easier to agree with smaller numbers of countries. Regional understanding and similarities may also facilitate closer political cooperation; and

- **Impetus for private sector planning and investment:** Regional economic integration can serve a useful economic purpose beyond the direct gains from trade liberalisation, by reducing uncertainties and improving credibility and thus making it easier for the private sector to plan and invest. Indeed, reducing uncertainty may be vital for realizing gains from liberalisation. Whether economies benefit from a particular regional trade agreement depends on the scope and coverage of its provisions, thenature of the enforcement mechanism and the circumstances in which the agreement can be modified.

ii Creation of regional economic integration and trade bloc agreements may lead to the followingdisadvantages:

- **Trade diversion:** The flip side to trade creation is trade diversion. Member countries may trade more with each other than with nonmember nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country. In this sense, inefficient companies can be protected inadvertently with the bloc agreement acting as a trade barrier. In essence, regional agreements have formed new trade barriers with countries outside of the tradingbloc;

- **Employment shifts and reductions:** Countries may move production to cheaper labour markets in member countries. Similarly, workers may move to gain access to better jobs and wages. Sudden shifts in employment can tax the resources of member countries;and

- **Loss of national sovereignty:** With each new round of discussions and agreements within a regional bloc, nations may find that they have to give up more of their political and economic rights.

20

Current issues and emerging trends

Contents

20.0 Purpose

After studying this chapter, readers should be able to explain the followings:

(a) Tax inspectors without borders
(b) Cooperative compliance
(c) Common reporting standards
(d) Foreign account tax compliance
(e) Mutual agreement procedures
(f) Country by Country reporting
(g) African Continental Free Trade Area Agreement (ACFTA)

20.1 Introduction

The current wave of globalization and technological revolution has had a tremendous effect on international taxation. The financial and economic liberalization has brought such sophistication and complexity into business practices that Nigeria tax administration is ill-equipped to cope with the emerging tax problems. Techniques for tax abuses have become too sophisticated for developing economies. Therefore, there is growing need to update tax administrator knowledge through continuous familiarization with some terms used in international tax.

20.2 Tax inspectors without borders

Tax Inspectors Without Borders (TIWB) is a joint new initiative of the Organization for Economic Co-operation and Development (OECD) and the United Nations Development Programme (UNDP) for delivering assistance needed to build tax audit capacity in developing countries, bridging the gap between theory and practice and complementing efforts from the international development community to help with a range of broader domestic resource mobilization (DRM) issues. As such, TIWB can make a significant contribution to DRM efforts by developing countries.

TIWB facilitates targeted, tax audit assistance programmes in developing countries across the globe. Under TIWB, tax audit experts work alongside local officials of developing country tax administrations on current direct and indirect tax audits and audit related issues concerning international tax matters and sharing general audit practices for specific cases. TIWB programmes can include pre-audit risk assessment and case selection, investigatory techniques, audit cases involving transfer pricing issues, anti-avoidance rules, or sector-specific issues, relating for example to natural resources, e-commerce, financial services or telecommunications.

The host administrations of developing countries are the lead partners in TIWB programmes, clearly specifying their needs and scope of work. TIWB assistance is delivered by current or recently retired tax audit experts. Audit experts work with the host administration under a programme agreement which covers all the legal and practical safeguards and provisions. The experts are not intended to act as a substitution of local audit staff or to carry out audit work where no local audit personnel would otherwise exist.

20.3 Cooperative compliance

Cooperative compliance is a tax planning strategy that is in a form of relationship between the revenue authority and a taxpayer with the objective of agreeing actions that ensure that taxpayer is tax compliant in an uncertain and controversial tax situation. The aim of cooperative compliance is to ensure that a business is fully tax compliant through a preventive dialogue with tax authorities.

In recent years, a growing number of tax authorities have shifted their strategies towards large organisations to include forms of so-called cooperative compliance programmes (OECD, 2013). These programmes require large organisations to have internal (or tax) control frameworks in place that assure that they can comply with their tax obligations and can also detect uncertain tax positions and disclose these to the tax authority. In exchange, the tax authority sees to it that tax matters are resolved quickly, quietly, fairly and with finality (OECD, 2007). Cooperative compliance programmes have therefore been characterised as "transparency in exchange for certainty".

20.4 Common reporting standards

The common reporting standards (CRS) is a standard for automatic exchange of bank account information on individuals and certain types of entities. All countries that have implemented the standard will be required to automatically exchange this information on an annual basis.

In August 2017, Nigeria took a step towards implementing the standard by signing the Multilateral Competent Authority Agreement (MCAA) on the CRS. Implementing the CRS will allow Nigeria to automatically receive information on the bank accounts held in other countries by Nigeria tax residents.

More than 95 countries such as the UK, Netherlands, Belgium, Japan, and China have implemented the CRS. Countries that have implemented the standards also includes several of the popular offshore financial centres such as Bermuda, Cayman Islands, Luxembourg, and Mauritius.

All the banks in each of these countries will collate the required information and send to their tax authorities. The relevant tax authorities will then collate the information that relates to Nigeria (and other countries that they have agreed to share information with) and share. Similarly, Nigerian banks will also be required to share information on the bank accounts held by individuals that are tax residents (and in some cases citizens) of other countries with the FIRS. The FIRS will then automatically share this information with these other countries. For this to happen, Nigeria should have implemented the CRS and activated exchange relationships with the relevant countries.

20.5 Foreign Account Tax Compliance Act (FATCA)

The Foreign Account Tax Compliance Act (FATCA) is a tax law that compels U.S. citizens at home and abroad to file annual reports on any foreign account holdings. FATCA was endorsed in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act to promote transparency in the global financial services sector.

FATCA provisions require all U.S. taxpayers to report yearly all assets held outside of the country. By taxing these foreign-held assets, the U.S. increases its revenue stream, which is put towards its incentive account for job stimulation. Penalties are imposed on U.S. residents who do not report their foreign account holdings and assets that exceed $50,000 in value in any given year.

Non-U.S. foreign financial institutions (FFI) and non-financial foreign entities (NFFE) are also required to comply with this law by disclosing the identities of U.S. citizens and the value of their assets held in their banks to the Internal Revenue Service (IRS) or the FATCA Intergovernmental Agreement (IGA). FFIs that do not comply with the IRS will not only be excluded from the U.S. market but will also have 30% of the amount of any withholdable payment deducted and withheld from them as a tax penalty. Withholdable payments in this instance refer to income generated from U.S. financial assets held by these banks and include interests, dividends, remunerations, wages and salaries, compensations, periodic profits, etc. FFIs and NFFEs that agree to the law must annually report the name, address, and tax identification number (TIN) of each account holder that meets the criteria of a U.S. citizen; the account number; the account balance; and any deposits and withdrawals on the account for the year.

Although the price to pay for not complying with FATCA is high, compliance costs are also high. TD Bank, Barclays, and Credit Suisse reportedly spent millions of dollars in fighting this law given that they faced compliance costs of about $100 million. Large banks like HSBC, Commerzbank, and Deutsche, following the enactment of the law, either limited the services offered to Americans or completely stopped serving U.S. investors to mitigate the high compliance cost.

FATCA seeks to eliminate tax evasion by American individuals and businesses that are investing, operating, and earning taxable income abroad. While it is not illegal to control an offshore account, failure to disclose the account is considered illegal since the United States taxes all income and assets of its citizens on a global scale.

20.6 Mutual agreement procedures (MAP)

Mutual agreement procedures (MAP) is a dispute resolution mechanism, established in tax treaties enforceable in Nigeria, through which a Nigerian taxpayer may request a competent authority, for example, the Minister of Finance or his authorised representative in Nigeria to engage the competent authorities of other countries with whom Nigeria has tax treaties to seek mutual resolution of tax issues affecting such taxpayer. MAP is triggered by taxpayers who is of the opinion that actions of either or both of the tax authorities may result in tax implications that are not for seen in the treaty.

20.7 Country by Country reporting

Country by country reporting (CbCr) is a report that provides certain financial information about each member of a multinational enterprise (MNE) group including permanent establishment and foreign branches. The information to be included in the CbCr includes revenues from related parties, profit or loss before income tax, income tax paid on cash basis, income tax accrued, stated capital, number of employees, retained earnings and tangible assets of each entity within the group.

20.8 African Continental Free Trade Area Agreement (ACFTA)

The African Continental Free Trade Area (AfCFTA) is a free trade area founded in 2018, with trade commencing as of 1 January 2021.It was created by the African Continental Free Trade Agreement among 54 of the 55 African Union nations.The free-trade area is the largest in the world in terms of the number of participating countries since the formation of the World Trade Organization. Accra, Ghana serves as the Secretariat of AfCFTA and was commissioned and handed over to the AU by the President of Ghana Nana Akufo-Addo on August 17, 2020 in Accra.

The agreement was brokered by the African Union (AU) and was signed on by 44 of its 55 member states in Kigali, Rwanda on March 21, 2018.The agreement initially requires members to remove tariffs from 90% of goods, allowing free access to commodities, goods, and services across the continent. The United Nations Economic Commission for Africa estimates that the agreement will boost intra-African trade by 52 percent by 2022. The proposal was set to come into force 30 days after ratification by 22 of the signatory states. On April 2, 2019, The Gambia became the 22nd state to ratify the agreement, and on April 29 the Saharawi Republic made the 22nd deposit of instruments of ratification; the agreement went into force on May 30 and entered its operational phase following a summit on July 7, 2019.

The general objectives of the agreement are to:

- Create a single market, deepening the economic integration of the continent;
- Establish a liberalised market through multiple rounds of negotiations;

- Aid the movement of capital and people, facilitating investment;
- Move towards the establishment of a future continental customs union;
- Achieve sustainable and inclusive socioeconomic development, gender equality and structural transformations within member states;
- Enhance competitiveness of member states within Africa and in the global market;
- Encourage industrial development through diversification and regional value chain development, agricultural development and food security; and
- Resolve challenges of multiple and overlapping memberships.

Benefits of **AfCFTA** to Africa Economy include:

- Creation a liberalised market for goods and services;
- Contribution to the movement of capital;
- Facilitation of investments through the creation of a large market;
- Serve as catalyse to the introduction of new technology to boost productivity;
- Enhancement of competitiveness of members' economies;
- Promotion of industrial development through diversification;
- Development of value addition systems for products;
- Elimination of tariffs on intra-Africa trade, making it easier for businesses to trade within Africa and benefit from their own growing market;
- Introduction of regulatory measures such as sanitary standards and eliminating non-tariff barriers to trade; and
- Could lead to establishment of a Common Continental Market in the future
.

Possible challenges to implementation of **AfCFTA** in Africa include:

- ✓ The agreement will mean harmonising Africa's heterogenous economies, despite their considerable variation in size, levels of economic development and diversification and it is hard to ensure broad-based gains for all members states;
- ✓ The AfCFTA has the greatest levels of income disparity of any continental free trade agreement. Many countries, especially the 32 least developed countries, face challenges to create jobs, develop their industrial sectors and diversify their production capacity; and
- ✓ In some countries, weak infrastructures, low technological uptake and conflicts will threaten the implementation of the agreement. A general fear of losing control and sense loss of identity across segments of the population has also been expressed.

Likely advantages of **AfCFTA** to Nigerian economy include:

- ➢ Expansion of market access for Nigeria's exporters of goods and services, spur growth and boost job creation;
- ➢ Elimination of barriers against Nigeria's products;
- ➢ Provision of a Dispute Settlement Mechanism for stopping the hostile and discriminatory treatment directed against Nigerian natural and corporate business persons in other African countries;
- ➢ Establishment of rules-based trade governance in intra-African trade to invoke trade remedies, safeguard the Nigerian economy from dumping and unfair trade practices;
- ➢ Support the industrial policy of Nigeria through the negotiated and agreed "Exclusion and Sensitive category lists" to provide space for Nigeria's infant industries;
- ➢ Improve competitiveness and the ease of doing business;
- ➢ Provision of a platform for Nigeria's continued leadership role in Africa;
- ➢ Consolidate and expand Nigeria's position as the number 1 economy in Africa;
- ➢ Stimulate increase in Nigeria's total exports, with a small structural shift in Nigeria's economy towards manufacturing and services. Changes would result from tariff reduction, ease of doing business and trade facilitation;

- Provision of a platform for Small and Medium Enterprises (SMEs) integration into the regional economy and accelerate women's empowerment; and
- Provision of an expanded platform for Nigerian manufacturers and service providers for connection to regional and continental value chains.

20.9 Chapter review

This chapter examines current issues and emerging trends. Readers must have learnt how to explain some issues in international tax as it affect cross-border transactions.

20.10 Worked examples

20.10. 1 Open-ended questions

(1) Explain the following terms:
   (a) Tax inspectors without borders
   (b) Cooperative compliance
   (c) Common reporting standards
   (d) Mutual agreement procedures
   (e) Country by country reporting

(2) The birth of African Continental Free Trade Area (AfCFTA) has been stated to be a welcome development by many African countries.

Required:
Explain the formation of African Continental Free Trade Area (AfCFTA and the goals of the trade agreement.

20.10.2 Suggested solutions to open-ended questions

(1) (a)

Tax Inspectors Without Borders (TIWB) is a joint new initiative of the Organization for Economic Co-operation and Development (OECD) and the United Nations Development Programme (UNDP) for delivering assistance needed to build tax audit capacity in developing countries, bridging the gap between theory and practice and complementing efforts from the international development community to help with a range of broader domestic resource mobilization (DRM) issues. As such, TIWB can make a significant contribution to DRM efforts by developing countries.

TIWB facilitates targeted, tax audit assistance programmes in developing countries across the globe. Under TIWB, tax audit experts work alongside local officials of developing country tax administrations on current direct and indirect tax audits and audit related issues concerning international tax matters and sharing general audit practices for specific cases. TIWB programmes can include pre-audit risk assessment and case selection, investigatory techniques, audit cases involving transfer pricing issues, anti-avoidance rules, or sector-specific issues, relating for example to natural resources, e-commerce, financial services or telecommunications.

The host administrations of developing countries are the lead partners in TIWB programmes, clearly specifying their needs and scope of work. TIWB assistance is delivered by current or recently retired tax audit experts. Audit experts work with the host administration under a programme agreement which covers all the legal and practical safeguards and provisions. The experts are not intended to act as a substitution of local audit staff or to carry out audit work where no local audit personnel would otherwise exist.

(b) **Cooperative compliance** is a tax planning strategy that is in a form of relationship between the revenue authority and a taxpayer with the objective of agreeing actions that ensure that taxpayer is tax compliant in an uncertain and controversial tax situation. The aim of cooperative compliance is to ensure that a business is fully tax compliant through a preventive dialogue with tax authorities.

In recent years, a growing number of tax authorities have shifted their strategies towards large organisations to include forms of so-called cooperative compliance programmes (OECD, 2013). These programmes require large organisations to have internal (or tax) control frameworks in place that assure that they can comply with their tax obligations and can also detect uncertain tax positions and disclose these to the tax authority. In exchange, the tax authority sees to it that tax matters are resolved quickly, quietly, fairly and with finality (OECD, 2007). Cooperative compliance programmes have therefore been characterised as “transparency in exchange for certainty”.

(c) **The common reporting standards (CRS)** is a standard for automatic exchange of bank account information on individuals and certain types of entities. All countries that have implemented the standard will be required to automatically exchange this information on an annual basis.

In August 2017, Nigeria took a step towards implementing the standard by signing the Multilateral Competent Authority Agreement (MCAA) on the CRS. Implementing the CRS will allow Nigeria to automatically receive information on the bank accounts held in other countries by Nigeria tax residents.
More than 95 countries such as the UK, Netherlands, Belgium, Japan, and China have implemented the CRS. Countries that have implemented the standards also includes several of the popular offshore financial centers such as Bermuda, Cayman Islands, Luxembourg, and Mauritius.

All the banks in each of these countries will collate the required information and send to their tax authorities. The relevant tax authorities will then collate the information that relates to Nigeria (and other countries that they have agreed to share information with) and share. Similarly, Nigerian banks will also be required to share information on the bank accounts held by individuals that are tax residents (and in some cases citizens) of other countries with the FIRS. The FIRS will then automatically share this information with these other countries. For this to happen, Nigeria should have implemented the CRS and activated exchange relationships with the relevant countries.

(d) **Mutual agreement procedures (MAP**) is a dispute resolution mechanism, established in tax treaties enforceable in Nigeria, through which a Nigerian taxpayer may request a competent authority, for example, the Minister of Finance or his authorised representative in Nigeria to engage the competent authorities of other countries with whom Nigeria has tax treaties to seek mutual resolution of tax issues affecting such taxpayer. MAP is triggered by taxpayers who is of the opinion that actions of either or both of the tax authorities may result in tax implications that are not foreseen in the treaty.

(e) **Country by country reporting (CbCr)** is a report that provides certain financial information about each member of a multinational enterprise (MNE) group including permanent establishment and foreign branches. The information to be included in the CbCr includes revenues from related parties, profit or loss before income tax, income tax paid on cash basis, income tax accrued, stated capital, number of employees, retained earnings and tangible assets of each entity within the group.

(2) The African Continental Free Trade Area (AfCFTA) is a free trade area founded in 2018, with trade commencing as of 1 January 2021.It was created by the African Continental Free Trade Agreement among 54 of the 55 African Union nations.The free-trade area is the largest in the world in terms of the number of participating countries since the formation of the World Trade Organization.

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The general goals of the agreement are to:

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- Enhance competitiveness of member states within Africa and in the global market;
- Encourage industrial development through diversification and regional value chain development, agricultural development and food security; and
- Resolve challenges of multiple and overlapping memberships.

Professional level

Advanced Taxation

21

International tax policy

Contents

International tax policy

21.0 Purpose

At the end of this chapter, readers should be able to know:

(a) The roles being played by inter-governmental and supranational or international organisations;

(b) Effectiveness of global cooperation and assistance on tax matters; and

(c) Neutralities in international taxpolicy.

21.1 Introduction

Globalization and technological revolution has had a tremendous effect on international taxation. Therefore, international organizations have to play key roles in developing policy that will shape global tax administration.

21.2 The roles being played by inter-governmental and supranational organizations that shape tax policy

International organizations are organs of institutional agreements amongst members of an international system for the purpose of achieving objectives that will meet the aspirations and concerns of its members.They are important actors in international politics, with power in mediation, dispute resolution, peace keeping, applying sanctions and others. Activities are based on the sovereignty of the nation-state. Examples of these organisations include Organisation forEconomicCooperation and Development (OECD), United Nations (UN), European Union (EU), World Bank, International Monetary Fund (IMF), African Union (AU), African Development Bank (AfDB).

The concept in terms of global governance promoted by the international organizations is legitimacy and customs.

21.3 The need for internationalorganizations

Each state is autonomous and governed in a peculiar way to reflect the natural characteristics of its people. This is a function of individual values. Therefore, there is the need for independent organizations to interact among individual nation states to achieve global objectives.

Some advantages of international organisations are as follows:

(a) States are able to delegate authority in matters requiring expertise, knowledge and information that are timely and relevant but not available at alltimes;
(b) States use international organizations as engines for cooperation; and
(c) International organizations can be a complement to national prevailing paradigm.

21.4 Issues of limitations to the functions of international organizations

As in all cases, there are always challenges confronting the attainment of stated objectives. International organizations are not exempted as they face the understated challenges:

(a) The structure and operations of these organizations;

(b) The independence of these organizations;

(c) The state can limit or extend their autonomy;

(d) The state from time to time interfere in their activities;

(e) The state has enough capacity to restructure or dissolve them; and

(f) They sometimes collide with the sovereignty of a state when they create new structures for regulating cross-border relationships.

21.5 Uniqueness of international organisations- Centralisations of power and decision makingautonomy

The unique attributes of international organizations are as stated below:

(a) International organisations carry out actions that enjoy a sort of legitimacy which sometimes affect the legitimacy of the stateactivity;

(b) Centralisation may alter the perceptions of the states in the context of complex interactions amongstthem;

(c) Centralisation outlines the political context of interactions among states;

(d) International organisations provide forums for neutral, depoliticised and specific discussions in a much more effective way than any otheragreements;

(e) They outline the specific terms of ongoing interactions between states and try balancing the relationships between stronger and weaker states, between interests andknowledge;

(f) The organisational structure influences the evolution of interstate cooperation and adapts itself to specificcircumstances;

(g) Most organisations perform functions to support cooperation between conferences dealing with very important issues, as well as implementing a set ofregulations; and

(h) International standards can be addressed as expectations of heads of state about internationalrelations.

21.6 The legitimacy of internationalorganizations

Legitimacy is a function of certain criteria that confer continuity and trust. International organizations seek to establish solid connections between their activities and social values system to which they belong. Legitimacy lies in the means by which to achieve the specific goal.

It must be noted, however, that the legitimacy problem that international organizations face is a threat to the global economic balance among other issues. Other challenges - the system itself is flawed and solutions must be found really quickly.

International organisations participate as independent and neutral actors on the global stage and can transform the relationships between states, increasing the efficiency and legitimacy of their individual or collective decisions.This feature requires the short or long term balanced actions depending on the interest of both sides: powerful states will not join any organization they cannot influence and small countries will not join any organization whose decisions undermine their sovereignty.

Authoritarian states are reluctant to allow international organizations to take decisions for them, decisions that interfere with their national policies.

21.7 Attributes of internationalorganizations

The unique attributes of international organizations are as stated below:

(a) Facilitatingnegotiations;

(b) Implementingagreements;

(c) Disputeresolution;

(d) Offering technical assistance and developingrules;

(e) Neutrality: this enables organizations to act as mediators among states and to implement theirdecisions;

(f) Impartiality: this suggests that neither party to a dispute is favoured; and

(g) Independence: this means that international organizations can take decisions for themselves that is binding on memberstates.

21.8 Assessment of the role of international organizations in the global economicgovernance

All organizations are expected to have standard objectives to enable comparism with actual results and achievements. Stated below are the extents of achievement of international organizations under consideration:

(a) Member states are forced to make concessions to each other in order to reach an agreement. As a last resort, unanimous voting or qualified majority voting becomesapplicable;

(b) There is a gap between demand, responsibility and jurisdiction of global governance and its institutional capacity to take decisions and implement effective solutions for global problems. This is associated with diminishing expectations that global institutions seem to reach and political demands are addressed, in part because of the lack of resources and because governments cannot deliver properly their institutional capacity (Moravcsik, 2004, Bradford and Linn,2007);

(c) Most global institutions are unable to take a firm decision leading to pressing problems that result to failure in advancing collective actions. These systemic failures lead to widening the disparities between promised collective actions and what reallycomes;

(d) The problem of legitimacy is directly related to the influence of the international organizations and often to state sovereignty. The principle of consensual decision-making is the main subject of critics, being argued that they shall be made only at formal level and must reflect the power relations between states taking the form of a weighted voting under major interests;

(e) The principle of consensus practiced within an international organization has always meant that all parties have to agree upon a specific issue which may not be so;and

(f) These institutions are being highly criticized by the developing world, as the system is tilted in favour of the rich and powerful countries. For example, whenever developing countries have the chance to gain from free trade, they have confronted quotas or voluntary export restrictions, dumping, safeguards or other forms oflimitations.

21.9 Conclusion

As discussed above, the various challenges surrounding these institutions only succeeded to shape individual country's tax policy using bilateral arrangement and agreement. Consequently, individual countries enter into tax treaties among themselves. Bilateral tax treaties have the advantage of addressing individual country's internal tax policies and arrangement with other countries, it also takes into consideration history and values between countries involved. It is, therefore, concluded that the activities gave birth to multiple tax treaties amongnations.

21.10 The effectiveness of globalcooperation

International tax cooperation focuses on the conclusion of bilateral tax treaties, which had the major aim of reducing double taxation. In addition, such cooperation has increasingly looked at setting tax norms to close loopholes and limit the ability of multi-national enterprises (MNEs) to avoid paying taxes.

The United Nations and the OECD are the two principle venues for the development of international tax norms. Their means include:

(i) The maintenance of model conventions andcommentaries;

(ii) Codes of conduct and guidance tocountries;

(iii) It is worth noting that it is only The United Nations that harnesses universal membership. The OECD, while not a universal membership body, has worked with the G-20 group of countries and has established forums open for interested country to participate, such as the global forum on transparency and exchange of information for tax purposes, which currently has over 140 members, and the inclusive framework on BEPS, currently with almost 100 members;

(iv) The OECD also serves as a coordinator and overseer of implementation of its agreements and has designed a number of multilateral conventions andinstruments;

(v) The United Nations and its agencies conduct international policy analysis, as do the OECD, World Bank and the International Monetary Fund;

(vi) The IMF and World Bank also work at the national level onpolicy analysis andrecommendations;

(vii) Examples of norm setting include model conventions and multilateral treaties. International policy analysis examples are research papers, handbooks, BEPS Action Plan reports. Oversight of implementation includes peer reviews and the assessment of compliance with internationalstandards;

(viii) National policy analysis and advice include surveillance, assessment of tax administrations, and policy proposals;and

(ix) Examples of capacity building work are the OECD/UNDP Tax Inspectors without borders initiative, the Global Tax Program of the World Bank, the UN DESA Capacity Development Unit, the OECD Global Relations programme and IMF technicalassistance.

21.11 Platform for collaboration ontax

The IMF, OECD, United Nations and the World Bank Group are working together under the platform for collaboration on tax, to enhance their cooperation and improve the support and assistance they provide to governments. The first report of the platform focused on how to improve external assistance to revenue mobilisation and was released in July 2016 to the G20 Finance Ministers and Central Bank Governors. It focused on the key enablers for successful reforms, with the need for a supportive political environment and to place reforms in part of a medium- term strategy the main focus.

21.12 The Nigerian factor

In January 1988, the convention on mutual administrative assistance in tax matters was jointly developed by the Organisation for Economic Cooperation and Development (OECD) and the Council of Europe. In2010, the convention was amended to align with international standards on information exchange for tax purposes and opened to all countriesin order to make it easier for them to benefit from a co-operative tax environment.

The amended convention came into force on June 1, 2011, with over 60 countries ratifying the convention as at April 8, 2015. Nigeria signed the Convention on May 29, 2013 and ratified it in April 2015. Nigeria's participation is expected to take effect three months after the deposition of the instrument of ratification with the OECD. Nigeria is in the process of completing the deposition of the instrument with the OECD.

21.13 Purpose of theconvention

The convention was developed to facilitate international cooperation among tax authorities in order to tackle tax avoidance and evasion. The convention aims to foster administrative assistance to enable governments enforce their tax laws while respecting the rights oftaxpayers. The aim of the convention for the tax authorities in participating jurisdictions are:

(a) Exchange of information, including simultaneous tax examinations and participation in tax examinationabroad;

(b) Assistance in recovery of tax claims;and

(c) Assistance in respect of service ofdocuments.

21.14 Taxes covered by theconvention

A wide variety of taxes covered in the conventioninclude:

(a) Taxes on income orprofit;

(b) Capital gains tax, including taxes on immovableproperty;

(c) Net wealthtax;

(d) Estate, inheritance or gifttax;

(e) General consumption taxes – including value added tax and sales taxes;

(f) Specific taxes on goods and services such as excise taxes;and

(g) Taxes on the use or ownership of motor vehicles or movable property.

The convention also covers compulsory social contributions payable to the government or institutions established under public law.

21.15 Exchange of information

The convention requires Nigeria and other participating jurisdictions to exchange information relevant for enforcing the domestic tax laws of the jurisdictions that are party to the convention. Apart from providinginformation available in tax files, participating jurisdictions are required to take all relevant steps to provide other signatory countries, with necessary information, upon request, automatically or spontaneously.

21.15.1 Exchange of information onrequest

Under this approach, one country ("Applicant State") may request for tax information relating to a particular case from the tax file of another country ("Requested State"). Where the information available in the tax files ofthe Requested State is not sufficient, it shall take all relevant measures toprovide the Applicant State with the information requested.

21.15.2 Automatic exchange ofinformation

This refers to information exchanged periodically on an automatic basis, without any prior request. Automatic exchange of information requires additional procedures to be mutually agreed between the countries that intend to exchange information automatically. After the relevant procedures are in place, parties are expected to automaticallytransmit information that is foreseeably relevant for the administration or enforcement of their domestic laws concerning the taxes covered by the convention.

21.15.3 Spontaneous exchange ofinformation

According to the convention, a jurisdiction is obliged to provide information to another participating jurisdiction without the latter requesting for it. This form of information exchange is beneficial where a jurisdiction has knowledge of tax affairs of any multinational corporation [MNC] that may result in a tax loss in another jurisdiction, reduction of taxes in one State that may increase taxes in the other jurisdiction, or a party supposes that there are tax savings by MNC resulting from artificial transfer of profits within the group.

In effect, spontaneous exchange of information may place focus on the tax planning activities of MNCs without any formal request. It does not require a mutual agreement between both countries.

21.16 Simultaneous tax examination

The convention also encourages participating jurisdictions to assist one another (upon agreement) in carrying out tax examination for mutual interest and for the purpose of exchanging relevant information.

Furthermore, the tax authority of a Requested State, upon application from the Applicant State, may agree that a representative of an Applicant State be present during relevant tax examination of particular taxable persons in its jurisdiction. Simultaneous tax audit across different jurisdictions is aimed at eliminating challenges faced by tax authorities during a tax audit due to the incomplete disclosure of relevant information relating to affiliated entities. Such examination may result into greater compliance burden to MNC as they have to deploy more resources for the purpose of simultaneous tax audits.

21.17 Other aims for tax authorities

At the request of the Applicant State, the Requested State shall take the necessary steps to recover tax claims of the Applicants State in its territory. At their quest of the Applicant State, the Requested State may implement procedures in service of documents, relating to judicial decisions, addressed to a taxpayer in the Requested State jurisdiction.

21.18 Implications for FIRS

The transfer pricing unit of the FIRS has identified adequate information in respect of transactions and tax returns of non-resident companies (“NRC”) as a challenge to assessing them to taxes. As soon as the convention comes into force, the FIRS will in theory have better access to information that it would previously not have had due to limitation in its authority to act outside Nigerian jurisdiction. With the convention, the FIRS can work with a wider scope of cooperation with more than 60 other jurisdictions. Some of the jurisdictions include most of the OECD member countries, some emerging economies (like India, Argentina) and some tax havens like Bermuda, British VirginIsland,Cayman Islands, Gibraltar, Isle of Man etc. Also, as the FIRS will be required to share information with other signatories to the Convention, the FIRS needs to invest more in information management systems that are robust and flexible. The FIRS will also need to build its in-house capacity for the purpose of simultaneous tax examinations and participating in tax audits abroad.

21.19 Multinational taxpayers need to be aware that the FIRS can acquire access to more information on the group operations and financials where necessary.

Similarly, the FIRS may have the right to request and receive the Country by Country Report ("CbCR") from participating countries which have taxpayers with Nigerian subsidiaries. The CbCR is information relating to the global allocation of the MNC's income and taxes.

In addition, the FIRS issued the guidelines in respect of Income Tax (Country by Country Reporting) Regulations which took effect from January 1, 2018. Salient points of these guidelines are as stated below:

(a) Where the group [parent entity and constituent entity resident in Nigeria] has a total consolidated revenue of sixty billion [N60b] or more in the immediate preceding year, it must file a country by country report with the FIRS;

(b) The filing date is 12 months from the last date of the reporting accounting year of the group; And

(c) The penalties for non compliance with filing of reports are:

- First month:₦10,000,000;
- Second and other subsequent months of noncompliance: ₦1,000,000 monthly;
- Incorrect and fake report:₦10,000,000; and
- Penalty for failure to notify FIRS: ₦5,000,000 for the first month and ₦10,000 for every other month the failure continues.

21.20 The takeaway

The ratification of the convention is a significant step in the administration of taxes in Nigeria. It will foster cooperation between the FIRS and other tax authorities in dealing with tax evasion and avoidance. The convention indicates that the FIRS is interested in determining the level of transparency regarding tax affairs of MNC. Consequently, taxpayers are to give greater attention to consistency of information across the entire group since they may be under greater scrutiny by the FIRS even though inconsistencies may not be intentional.

Also, the convention will address some of the challenges anticipated with respect to administration of taxes for non-resident companies (NRC).

For example, verification of foreign tax treatment of shared costs and expenses incurred abroad but attributable to the operations of the NRC in Nigeria.

21.21 Evaluation of the use of neutralities in international tax policy

A neutral tax is one that does not motivate firms or individuals to change their behavior. Do I invest more or less? Do I work more or less? Do I locate in one place rather than another? Do I employ more or less labour or more or less capital?

Neutrality is an accepted standard for evaluating taxes.

In several cases, the concept of neutrality provides a useful way to cut through some of the debates about tax policy and identify a more economically efficient way to organize the tax system.

21.22 The concept of tax neutrality

The primary purpose of the tax system is to raise the revenue needed to pay for government spending. As such, the goal is to raise this revenue without distorting the decisions that individuals and firms would otherwise make for purely economic reasons.

Non-neutralities in the tax system lead people and firms to devote more socially wasteful effort to transforming the form or substance of their activities to reduce their tax payments, for example, by hiring accountants to structure financial transactions in a manner that minimizes tax liability.

In some cases, deviations from a neutral tax system are unavoidable. It is widely agreed that tax payments should increase with some measure of well-being, like income, consumption or wages.

One inevitable consequence of this agreement is that the market consumption of goods and services will be taxed, either directly (as in a consumption tax) or indirectly (as in an income or employment tax, both of which tax the money used to purchase consumption goods). In other cases, deviations from a neutral tax system reflect the goals of policy makers.

21.23 Three applications of neutrality to policy issues

This general discussion motivates the application of the concept of neutrality to five specific issues.

(a) **Overall tax reform: A broader base and lower rates**

One of the traditional mantras of tax reform is to “broaden the base and lower the rates. This involves two objectives:

(i) Broadening the base helps make the tax code more neutral between different activities by including more types of income in the definition of income and allowing fewer deductions and credits for specified activities ;and

(ii) Lowering tax rates makes the tax code more neutral about the choice between working and not working. Both halves of the process potentially improve efficiency.

(b) **Using the tax code to encourage desired behavior: Credits instead of deductions**

In some cases, policymakers may want to encourage desired activities like home ownership or a college education. In these cases, it is worth examining whether the specific goal could be better accomplished through a spending program or through the tax code. In many cases, a spending program can be more effectively targeted and delivered to serve the goal in question. In some cases, subsidizing these activities through the tax code may be more efficient.

(c) **Discouraging undesired activity**

Just as it can sometimes be appropriate to introduce non-neutralities into the tax system to encourage desired activities so can it be appropriate to use the tax system to discourage undesirable ones like smoking, drinking alcohol, or emitting carbon. In this manner, this can lead businesses and consumers to take the social costs of their actions into account, helping to ensure that the outcome of decentralized decisions and market competition leads to overall social efficiency.

21.24 Chapter review

This chapter examines the international tax policy with respect to roles being played by the inter-governmental and multinational organisations that shape global tax policy.

Readers must have learnt the uniqueness of international organizations and their roles in global economic governance.

21.25 Worked examples

21.25.1 Open-ended questions

(1) Evaluate the roles being played by inter-governmental and supra national organizations in global economic governance

(2) Demonstrate the effectiveness of global cooperation and assistance on tax matters.

(3) Explain the concept of Neutralities in international tax policy.

21.25.2 Suggested solutions to open-ended questions

(1) The role of international organizations in the global economic governance are as stated below:

(a) Member states are forced to make concessions to each other in order to reach an agreement. As a last resort, unanimous voting or qualified majority voting becomes applicable;

(b) There is a gap between demand, responsibility and jurisdiction of global governance and its institutional capacity to take decisions and implement effective solutions for global problems. This is associated with diminishing expectations that global institutions seem to reach and political demands are addressed, in part because of the lack of resources and because governments cannot deliver properly their institutional capacity;

(c) Most global institutions are unable to take a firm decision leading to pressing problems that result to failure in advancing collective actions. These systemic failures lead to widening the disparities between promised collective actions and what really comes;

(d) The problem of legitimacy is directly related to the influence of the international organizations and often to state sovereignty. The principle of consensual decision-making is the main subject of critics, being argued that they shall be made only at formal level and must reflect the power relations between states taking the form of a weighted voting under major interests;

(e) The principle of consensus practiced within an international organization has always meant that all parties have to agree upon a specific issue which may not be so; and

(f) These institutions are being highly criticized by the developing world, as the system is tilted in favour of the rich and powerful countries. For example, whenever developing countries have the chance to gain from free trade, they have confronted quotas or voluntary export restrictions, dumping, safeguards or other forms of limitations.

(2) International tax cooperation focuses on the conclusion of bilateral tax treaties, which had the major aim of reducing double taxation. In addition, such cooperation has increasingly looked at setting tax norms to close loopholes and limit the ability of multi-national enterprises (MNEs) to avoid paying taxes. The United Nations and the OECD are the two principal venues for the development of international tax norms. Their means include;

(a) The maintenance of model conventions and commentaries;

(b) Codes of conduct and guidance to countries;

(c) It is worth noting that it is only The United Nations that harnesses universal membership. The OECD, while not a universal membership body, has worked with the G-20 group of countries and has established forums open for interested country to participate, such as the global forum on transparency and exchange of information for tax purposes, which currently has over 140 members, and the inclusive framework on BEPS, currently with almost 100 members;

(d) The OECD also serves as a coordinator and overseer of implementation of its agreements and has designed a number of multilateral conventions and instruments;

(e) The United Nations and its agencies conduct international policy analysis, as do the OECD, World Bank and the International Monetary Fund;

(f) The IMF and World Bank also work at the national level on policy analysis and recommendations;

(g) Examples of norm setting include model conventions and multilateral treaties. International policy analysis examples are research papers, handbooks, BEPS Action Plan reports.
Oversight of implementation includes peer reviews and the

assessment of compliance with international standards;

(h) National policy analysis and advice include surveillance, assessment of tax administrations, and policy proposals; and

(i) Examples of capacity building work are the OECD/UNDP Tax Inspectors without borders initiative, the Global Tax Program of the World Bank, the UN DESA Capacity Development Unit, the OECD global relations programme and IMF technical assistance.

(3) The primary purpose of the tax system is to raise the revenue needed to pay for government spending. As such, the goal is to raise this revenue without distorting the decisions that individuals and firms would otherwise make for purely economic reasons.

Non-neutralities in the tax system lead people and firms to devote more socially wasteful effort to transforming the form or substance of their activities to reduce their tax payments, for example, by hiring accountants to structure financial transactions in a manner that minimizes tax liability.

In some cases, deviations from a neutral tax system are unavoidable. It is widely agreed that tax payments should increase with some measure of well-being, like income, consumption or wages.

One inevitable consequence of this agreement is that the market consumption of goods and services will be taxed, either directly (as in a consumption tax) or indirectly (as in an income or employment tax, both of which tax the money used to purchase consumption goods). In other cases, deviations from a neutral tax system reflect the goals of policy makers.

Professional level

Advanced Taxation

22

Mergers and acquisitions

Contents

Mergers and acquisitions

22.0 Purpose

After studying this chapter, readers should be able to:

(a) understand the concept of mergers, acquisitions and takeover;

(b) understand the benefits associated with mergers, acquisitions and takeover;

(c) understand the powers of Federal Inland Revenue Service with respect to mergers, acquisitions and takeovers;

(d) know the implications of a new company taking over an existing one;

(e) understand the tax implications of an existing company absorbing another;

(f) know the tax implications of trade or business sold or transferred; and

(g) understand the tax implications of reconstituted companies

22.1 Introduction

Mergers and acquisitions

Merger and acquisition is a form of business combination whereby two or more companies join together to become one enlarged surviving company. It can also be described as an arrangement in which the assets, liabilities and businesses of two or more companies are vested in and carried on by one company which may or may not be one of the merging companies.

(a) **Horizontal merger**

This involves a merger involving companies in the same line of business (producing similar goods or providing similar services) e.g. merger of two banks (former Chartered Bank and IBTC merged to become Stanbic IBTCBank Plc.)

(b) **Vertical merger**

A merger between two businesses in the same industry where one company supplies goods to the other company. An example is a soft drink company merging with a bottle making company.

(c) **Acquisition**

Acquisition is said to involve the purchase of all or majority of the equity shares of one or more companies by another company: Where A limited acquires more than 50% of the equity shares of companies B & C, these B & C become subsidiaries of A, and A becomes the holding company.

22.2 Benefits of mergers and acquisitions

A well consummated merger and acquisition exercise can lead attainment of the following benefits:

a. Improved management;

b. Operating economies (Economies of Scale);

c. Growth;

d. Tax shield;

e. Increased market power;

f. Improved financing; and

g. Diversification and risk reduction.

22.3 Mergers and acquisitions – powers of Federal Inland Revenue Service (FIRS)

The consent of the Federal Inland Revenue Service, including clearance with respect to any capital gains tax that may be due and payable, must be obtained before any merger, take-over, transfer or restructuring of a trade or business carried on by a company can take place. The Companies Income Tax Act (CITA) gave the FIRS powers to the extent that no merger can be consummated without obtaining the consent or direction of the FIRS. Under CITA, no merger, take-over, transfer or restructuring of the trade or business carried on by a company can take place without having obtained the FIRS's direction and clearance with respect to any tax that may be due and payable.

22.4 Mergers, acquisitions and takeovers

22.4.1 Tax implication of mergers, acquisitions and takeovers

The tax implications of amalgamation, absorption and takeovers, depend on the particular type of arrangement effected by the companies and the result of such arrangement. The common possibilities are as follows:

New company takes over an existing company

Where a new company takes over an existing or old company, the old company is deemed to have ceased business while the new company is deemed to have commenced a new business. The cessation rules will apply to the old company, while the commencement rules will apply to the new company. For the new company, the following will also be applicable:

i. Filing of annual returns – The new company that emerges from a merger process is expected to file audited accounts and returns with the FIRS within eighteen months from the date of its incorporation or not later than six months after the end of its first accounting period, whichever is earlier. Meanwhile, it should be noted that a mere change of name of an existing business entity does not constitute a new company. Such companies will continue to be treated as old businesses on ongoing concern basis.

ii. Basis of assessment – The commencement rules will apply to the new company and possibility of exercising the right of election.

iii. Claim of capital allowances – No initial or investment allowance will be claimed on the transferred assets. The annual allowance claimable will be based on the tax written down value of the transferred assets.

iv. Unabsorbed losses and capital allowances brought forward – The unrelieved losses and unabsorbed capital allowances of the individual merging companies will not be allowed to be carried forward and set off against the assessable profits of the new company after the merger. However, the utilised capital allowances may be added to the tax written down value of the assets taking over for annual allowance purposes in the enlarged entity.

v. Stamp duties – Stamp duty payment will arise on the share capital of the new company. If a merger also results in increase in share capital, stamp duty will be paid on the increase in share capital. Besides, merger of companies will also involve the sale/transfer of assets of the merging companies to the new company, necessary transfer or sale documents must be prepared to reflect the change of title. Stamp duties will be paid on documents perfecting these titles in accordance with the Stamp Duties Act.

vi. Merger cost – There are some costs which are incurred in the merger process due to the involvement of professionals and regulatory agencies, for example, financial advisers, solicitors, stockbrokers, estate valuers, issuing houses, corporate affairs commission, Nigerian Stock Exchange, Securities and Exchange Commission. The FIRS may seek to disallow these expenses on the basis that they are capital in nature and as such not tax deductible.

vii. Value added tax and withholding tax – The fees paid to the professionals for services rendered in connection with the merger will attract value added tax and withholding tax at the appropriate rates.

viii. Guarantee or security for payment of tax – The FIRS may require the new company to guarantee or give security to the satisfaction of the FIRS, for the payment in full of all tax due or to become due by any of the ceased companies.

ix. End of service award – When companies merge, the services of some employees may no longer be needed. The new company may have to pay benefits such as gratuity, compensation for loss of employment and other retirement benefits. These expenses will be treated as allowable for the new company.

22.4.1.1 An existing company absorbs another existing company

Where an existing company absorbs another existing company:

i. The company absorbed will be deemed to have ceased business and the cessation rules will apply to it.

The company that absorbs will not be deemed to have commenced a new business as far as the nature of business carried on by it before and after the absorption is not different from that of the company absorbed or taken over. Therefore, commencement provision will not apply to it and tax returns will be filed as an ongoing company. This is what happened when MTN absorbed

Visafone. MTN was treated as an ongoing company while cessation was applied to Visafone.

ii. The surviving company will not be entitled to investment allowance and initial allowance on the assets transferred to it. The annual allowance claimable will be based on the tax written down values.

iii. The unabsorbed losses and capital allowances of the individual merging companies may not be allowed to be carried forward and set off against the assessable profits of the surviving company after the me

iv. Fees payable for professional services in connection with the merger or consolidation will be subject to VAT and WHT.

v. Any increase in share capital as a result of a merger will attract payment of stamp duties.

22.4.1.2 Merger resulting in the cessation of business of the merging companies

Where a merger results in the cessation of business of all the merging companies:

The cessation provisions will apply to those companies which have ceased business permanently.

i. Any unrelieved capital allowances at cessation can be carried backward and set off against assessable profit of five years preceding the year of cessation.
ii. Any unrelieved losses at cessation cannot be carried backward to be set off against the assessable profits of the preceding years of assessment.
iii. Any sum received or paid by the company, its receivers or liquidators after the date of cessation will be deemed to have been received or paid on the last day before such cessation occurred.

22.4.1.3 Trade or business sold or transferred: Section29 (9)

If a trade or business is sold or transferred to a Nigerian company together with any asset employed therein and the Revenue Service is satisfied that one of the companies has control over the other or that both are controlled by some other person or are members of a recognised group of companies, the Revenue Service may at its discretion direct that:

(a) The commencement and cessation provisions are not applied;
(b) For capital allowances purposes, the assets sold or transferred shall be deemed to have been sold for an amount equal to the residue of qualifying expenditure thereon on the day following such sale or transfer; and
(c) the company acquiring the assets shall not be entitled to any initial allowance thereon and shall be deemed to have received all allowance already granted to the vendor company up to the date of the sale or transfer.

There is no reference to unutilised losses incurred in the old trade. Such losses cannot be transferred to the new business and may not be relieved in any other way. Any company planning a reorganisation that will involve transfer of business from one subsidiary to the other within the group, will need to consider this fact.

That is, the unabsorbed losses on the date of the transfer or sale of the business cannot be transferred to the new business. A way out is to leave some business in the old trade that will produce small profits annually which will gradually use up the losses over a number of years, before that part of the trade is transferred to the new trade.

22.4.1.4 Reconstituted companies: section 29(10)

Where in pursuance of Chapter 3 of Part II of the Companies and Allied Matters Act, a company – "the reconstituted company" – is incorporated to carry on a trade or business previously carried on by a foreign company, and the assets employed by the foreign company in that trade or business vest in the reconstituted company, then the following provisions shall apply:

(a) The commencement and cessation provisions shall not apply to the reconstituted company;

(b) The assets vested in the reconstituted company shall be deemed to have been sold to it, on the day of incorporation of that company, for an amount equal to the residue of qualifying expenditure thereon, on the day following the cessation of the foreign company's trade;

(c) The reconstituted company shall not be entitled to any initial allowance on those assets and shall be deemed to have received all capital allowances granted the foreign company on those assets;

(d) Unrelieved losses of the foreign company on the date of the reconstitution, shall be deemed to have been incurred by the reconstituted company in its trade or business during the first year of assessment and shall be deductible from its assessable profits. Losses arising from damages caused by any civil war, cannot be so transferred to the reconstituted company except with the approval of the Federal Executive Council. It is also to be noted, that a claim for the deduction of such losses, must be lodged with the Director of the Industrial Inspectorate Division of the Federal Ministry of Industries, with a copy to the Revenue Service within three years of the incorporation of the reconstituted company; and

(e) Deduction of such losses is to be made from the assessable profits, if any, of the reconstituted company, for the first year of assessment and so far as it cannot be so made, then from the amount of the assessable profits of the year of assessment and so on, up to the fourth year after the commencement of such business. The foregoing will only be applicable, if the Revenue Service is satisfied that the trade or business carried on by the reconstituted company immediately after its incorporation, is not substantially different in nature from that previously carried on in Nigeria by the foreign company.

22.5 Advise on entities involved in business re-organisation and restructuring on :

Tax concessions:

Where there is business re-organisation and restructuring (i.e. sale or transfer) among entities that are related, the following tax concessions are applicable:

i. The commencement and cessation provisions are not applied;

ii. For capital allowances purposes, the assets sold or transferred shall be deemed to have been sold for an amount equal to the residue of qualifying expenditure thereon on the day following such sale or transfer; and

iii. The company acquiring the assets shall not be entitled to any initial allowance thereon and shall be deemed to have received all allowance already granted to the vendor company up to the date of the sale or transfer;

(iv) There is no reference to unutilised losses incurred in the old trade. Such losses cannot be transferred to the new business and may not be relieved in any other way. Any company planning a reorganisation that will involve transfer of business from one subsidiary to the other within the group, will need to consider this fact. That is, the unabsorbed losses on the date of the transfer or sale of the business cannot be transferred to the new business. A way out is to leave some business in the old trade that will produce small profits annually which will gradually use up the losses over a number of years, before that part of the trade is transferred to the new trade.

Conditions to be met before qualifying for such tax concessions:

The Finance Act, 2019 introduced Amendment to Section 29(9) of CITA to the effect that:

- Qualification for exemption from commencement and cessation rules in a business restructuring amongst related parties to now include requirements to be related for a period of at least one year prior to the restructuring.
- No disposal of assets post restructuring until after one year.
- Flouting of this provision will lead to a revocation of the exemption.

22.6 The main highlights

(a) Emergence of a new company

i. Rendition of annual returns
ii. Commencement rules under Section 29(3)applies
iii. Claim of allowances
iv. Unabsorbed losses and un-utilised capital allowances brought forward
v. Taxes and related expenses

- Stamp Duties
- Fees for SEC, NSE, CBN, land authorities, professional fees etc may have to be capitalised
- Professional fees is liable to Value Added Tax
- Professional fees will be subjected to withholding tax deductions

(b) **Where one of the merging companies survives with its old name or a new name**

i. Surviving company must file returns not more than six months after the end of its accounting year
ii. Commencement rules will not be applicable
iii. No investment allowance on assets transferred
iv. No initial allowance on assets transferred
v. Claim of annual allowance on tax written down value (TWDV) of the assets inherited

vi. Not to inherit the unabsorbed losses and unutilised capital allowance of the merger except there is evidence the company is reconstituted
vii. Fees to be liable to VAT and WHT
viii. Stamp duties to be paid on increase in share capital

(c) **Where cessation of business occurs for any of the merging companies**

i. Cessation rule as applicable under Section 29(4) of CITA
ii. Cessation may not be applicable where the merging companies are connected in line with the service discretionary powers under Section 29(9) of CITA
iii. Cessation may not be applicable where a reconstituted company is formed to take over the trade or business formerly run by its foreign parent company.

(d) **Capital gains tax**

Where the shares of the acquirer are issued in exchange for the shares of the acquired company (i.e. share for share exchange), the transaction is exempted from capital gains tax. However, where Shareholders are either wholly or partly paid in cash for surrendering their shares in the ceased business, the gains arising from such cash payment will be subject to Capital Gains Tax (CGT) contrary to the provision of Capital Gains Tax Act which exempted gains from disposal of stocks and shares from CGT effective 1st January 1998.

22.7 Tax planning options under mergers, acquisition and takeovers

In mergers, acquisition and takeover of business, the following tax planning options should be taken into consideration:

i. Merger consideration pay off by shares are not liable to capital gain tax, as provided in the provisions of Capital gains Tax Act of 2004 CAP CI LFN. Therefore, where consideration is to be offered, it should be in shares.

ii. Whether the merger is between related or unrelated companies, where the assets of the companies are taken over at market values, capital allowance will be claimable on the transferred value, as against the tax written down values, with the consent of the FIRS

iii. Where the new company is deemed to have commenced a new business, the taxpayer's option (i.e. right of election) under the provisions of Companies Income Tax Act (CITA) should be applied, where it is favourable to the company.

iv. Where the new company is deemed to be continuing in business, any unrelieved loss of the individual companies can be carried forward by the new company.

v. Where there is reinvestment of proceeds of sales of assets, roll over relief can be claimed.

22.8 Chapter review

This chapter discusses the tax implications of mergers, acquisitions and takeovers. It was noted that the consent of the Federal Inland Revenue Service must be obtained before any merger, take-over, transfer or restructuring of a trade or business carried on by a company, can take place.

22.9 Worked examples

22.9.1 Open-ended questions

(1) At a recent quarterly round-table discussion programme organised by a reputable Nigerian manufacturers" association in Warri, the issue of how business enterprises could cope under the prevailing difficult operating and economic climate in both domestic and foreign markets was discussed. One of the lead discussants, in his submission, encouraged firms especially in related industry or line of business to consider the option of merger or acquisition. His suggestion was premised upon the synergy from business operations and economies of scale that would result from it.

Partway Agro-allied Limited, a private limited liability company, based in Okomu, Edo State, with interests in cultivation and sales of fruit crops, such as mango, pineapple and cashew was represented at the programme by its Managing Director and Chief Executive, Mr. Charles Obuoro .In his contribution, Charles Obuoro, whose company was being ravaged by poor agricultural yield and low revenue in the last three years, however, accepted the submission of the lead discussant, but with reservation. His major area of concern was the tax implications to companies that are involved in merger or acquisition. The other participants who spoke on the issue were unable to convince him beyond reasonable doubt. Oxy Foods Limited is a leading juice-making company located in a major city in the South Western part of the country. The company was having an issue with sourcing for its raw materials (edible fruits). The director of the company, Mr. Bolaji Bakare, who also attended the event during the plenary session, had preliminary discussion with Charles Obuoro on the possibility of merger or acquisition of their business entities. Both senior officials promised to discuss the possibility of merging the two companies with their respective management and board for consideration and approval.

An emergency meeting of the Board of Directors of Partway Agro-allied Limited has been scheduled for the next three weeks, purposely to discuss and take a position on the possibility of being merged with or acquired by Oxy Foods Limited under any of the following scenarios:
(i) Complete acquisition by Oxy Foods Limited, while both Partway Agro-allied Limited and Oxy Foods Limited would cease operations and a new company would arise from the process;
(ii) To merge with Oxy Foods Limited, the new company will also inherit all the assets and operations of the merged companies. The company‟s new name will be Oxy Foods Limited; and
(iii) As a result of merger with Oxy Foods Limited, Partway Agro-allied Limited will cease operations.

You have been appointed as the tax consultants for Partway Agro-allied Limited and your mandate is to offer professional advice that will assist management in selecting the best option that will be beneficial to its shareholders.

Required:
You are to draft a report to the Managing Director and Chief Executive of Partway Agro-allied Limited, explaining the following:

a. The differences between merger and acquisition, giving suitable examples.
b. The tax implications of two companies in the same industry merging with each other, where:
i. An entirely new company emerges from the process.
ii. One of the merging companies survives with its old name or new name.
iii. Where any of the merged companies ceased business operations.
c. The possible tax effect on gains accruing to the shareholders of Partway Agro-allied Limited for surrendering their shares in exchange for cash and/or equity shares from the new company that will emerge from the merger.

(2) (a) Explain the terms:
i. Mergers
ii. Acquisitions

(b) Briefly explain the tax implications of a company, merging with another company, where one of them inherits all the assets and operations of the merging companies.

(3) Briefly explain the tax implications of:
a. Cessation of business for one of the merging parties.
b. Cessation of business where a reconstituted company is formed to take over the trade or business formerly run by its foreign parent company.

(4) What are the tax implications of selling or transferring a company to another company where both companies belong to the same holding company?

(5) Explain the tax implications of the following:
a. Two or more companies enter into a joint venture agreement or partnership.
b. Where shareholders are wholly or partly paid in cash for surrendering their shares in a ceased business.

22.9.2 Suggested solutions to open-ended questions

(1)

Ahmed Kelechi & Co. (Chartered Accountants)
13, Long Avenue, Warri, Delta State

September 10, 2019

The Managing Director
Partway Agro-allied Limited
KM 45, Okomu, Edo State

Dear Sir,

Re: Proposal on merger or acquisition- Oxy Foods Limited.

Further to our discussion and subsequent engagement as your tax consultants, please find below our comments on the related issues of merger or acquisition:

a. Differences between merger and acquisition

(i) A merger is an arrangement in which the assets, liabilities and businesses of two or more companies are vested in and carried on by one company, which may or may not be one of the merging companies and under a situation in which the new company is owned by the owners of the merging companies.

(ii) Two types of merger are common. These are horizontal merger and vertical merger. Horizontal merger involves a merger of companies in the same line of business producing similar goods or providing similar services. On the other hand, vertical merger involves a merger between two entities in the same industry.

(iii) Acquisition is the art of acquiring effective control over assets or management of one or more companies by another company by acquiring all or majority of the equity shares or voting rights of the company or companies.

(iv) Where a company (X Limited) acquires more than 50% of the equity shares of another companies (Y Limited and Z Limited), the Y Limited and Z Limited become the subsidiaries of X Limited, while X Limited becomes the holding company.

b i. Tax implications of two companies in the same industry merging with each other where an entirely new company emerges from the process:

- ✓ Rendition of annual returns;
- ✓ Commencement provisions of the law under Section 29(3) will apply;
- ✓ Claim of capital allowances on qualifying capital expenditure will be deemed to have been taken over at their tax written down values;
- ✓ Unabsorbed losses and un-utilised capital allowances brought forward by the old company cannot be carried forward to the new company;
- ✓ Taxes and related expenses (stamp duties, fees for SEC, NSE, CBN, land authorities, professional fees that is liable to VAT and WHT deductions, etc) to be capitalised; and
- ✓ Any cost associated with the merger or arrangement shall not be allowed for tax purposes.

ii. One of the merging companies surviving with its old name or new name
Surviving company must file returns not more than 6 months after the end of the accounting year.

- ✓ Commencement rules will not be applicable.
- ✓ No investment allowances on assets transferred.
- ✓ No initial allowance on assets transferred.
- ✓ Claim of annual allowance on tax written down value (TWDV) of the assets inherited.
- ✓ Not to inherit the unabsorbed losses and unutilised capital allowance of the merger unless there is evidence that the company is reconstituted.
- ✓ Professional service fees to be liable to VAT and WHT.
- ✓ Stamp duties to be paid on increase in share capital.

iii. Where any of the merged companies ceased business operation

- ✓ Cessation rule will be applicable under Section 29(4) of CITA Cap C21 LFN 2004 (as amended).
- ✓ Cessation may not be applicable where the merging companies are connected in line with the discretionary powers of the Revenue Services under Section 29(9) of CITA Cap C21 LFN 2004 (as amended).
- ✓ Cessation may not be applicable where a reconstituted company is formed to take over the trade or business formerly run by its foreign parent company.
- ✓ Any unrelieved loss in the year of cessation is a terminal loss.

c. Possible effect on gains accruing to the shareholders of Partway Agro-allied Limited for surrendering their shares in exchange for cash and/or equity shares received from the new company

(i) Where the shares of the acquirer are issued in exchange for the shares of the acquired company (i.e. share for share exchange), the transaction is exempted from capital gains tax.

(ii) Where shareholders are either wholly or partly paid in cash for surrendering their shares in the ceased business, the gains arising from such cash payment will be subject to capital gains tax at 10% contrary to the provision of capital gains tax Act which exempted gains from disposal of stock and shares from CGT effective January 1, 1998.

It is pertinent to note that in any business combination, the consent of the Federal Inland Revenue Service must be sought and clearance obtained regarding the full liabilities of companies involved in the combination have been settled.

We shall be pleased to provide further clarification on this matter if the need arises.

Yours faithfully

For: Ahmed Kelechi & Co.

Mercy Ahmed
Managing Partner

(2) (a) **Mergers and Acquisitions**

A merger is an arrangement in which the assets, liabilities and businesses of two or more companies are vested in and carried on by one company, which may or may not be one of the merging companies and under a situation in which the new company is owned by the owner of the merging companies.

Acquisition is the act of acquiring effective control over assets or management of a company by another company by acquiring substantial shares or voting rights of the target company.

(b) (i) The surviving company must file returns not more than six months after the end of its accounting year in accordance with Section 55(3(a).

(ii) Commencement rule will not be applicable
(iii) No initial allowance on assets transferred
(iv) Claim of annual allowance on tax written down values of the assets transferred
(v) The company cannot inherit the unabsorbed losses and unutilized capital allowances of the merger unless there is evidence that the company is reconstituted
(vi) All fees paid will be liable to VAT and WHT
(vii) Stamp duties will be paid on increase in share capital

(3) (a) Cessation rules will be applicable in accordance with provision of Section 29(4) of CITA. However, the cessation rule will not be applicable where the merging companies are connected. This is a discretionary power of the Federal Inland Revenue Service in accordance with the provision of Section 29(9) of CITA.

(b) A re-constituted company is one registered in Nigeria to take over the assets of a foreign company in Nigeria. For a reconstituted company,

(i) There will be no application of either the commencement or cessation rules.
(ii) All the qualifying capital expenditure transferred are deemed to have been made at their tax written down values. The balancing adjustment may be computed.
(iii) In the computation of capital allowance, no initial allowance may be computed while the annual allowance would be based on the unexpired tax life of the qualifying capital expenditure.
(iv) Any unutilized capital allowances transferred are deemed to have been transferred prior to sale
(v) Any unrelieved losses transferred are deemed to have been incurred on the first day of the reconstitution. Such a loss is then available for relief against the taxable profit of the year of reconstitution and the three subsequent tax years.

(4) Where a company is sold or transferred to another company either for the purpose of better organization or transfer of management and provided that the Revenue is of the opinion that both companies belong to the same group:

(a) There will be no application of either the commencement or cessation rules;

(b) All the qualifying capital expenditure transferred are deemed to have been made at their tax written down values;

(c) In the computation of capital allowance, no initial allowance may be computed while the annual allowance would be based on the unexpired tax life of the qualifying capital expenditure;

(d) Any unutilized capital allowances transferred are deemed to have been transferred prior to sale; and

(e) Any unrelieved losses transferred are also deemed to have been relieved prior to the transfer or sale.

(5) (a) Where two or more companies enter into a joint venture agreement or partnership, then:

(i) The joint venture partnership is not chargeable to tax itself.

(ii) The profit chargeable to tax in the hand of each of the partners is the share of profit from the partnership.

(iii) Capital allowances on the assets of the partnership shall be shared in the agreed profit and loss sharing ratio.

(iv) Where any of the companies involved in the partnership has another line of business, the loss generated from the business will not be available for relief against the profit generated from the partnership.

(b) Where the shares of the acquirer are issued in exchange for the shares of the acquired company (i.e. share for share exchange), the transaction is exempted from capital gains tax. However, where Shareholders are either wholly or partly paid in cash for surrendering their shares in the ceased business, the gains arising from such cash payment will be subject to Capital Gains Tax (CGT) contrary to the provision of Capital Gains Tax Act which exempted gains from disposal of stocks and shares from CGT effective January 1,1998.

23

Tax practice management

Contents

Tax practice management

23.0 Purpose

After studying this chapter, readers should be able to:

(a) understand the process of tax consultant's engagement by the clients;

(b) understand the roles of various tax practitioners in tax practice;

(c) understand the nature of documents to be kept by the client and tax consultant under the engagement;

(d) understand types of services that could be rendered by tax consultants to their clients; and

(e) know the code of ethics expected of Revenue officials and tax consultants.

23.1 Introduction

Tax practice involves services ranging from compliance, planning and advocacy. Tax compliance services deal with timely filing of tax returns and payment of required taxes to the relevant tax authorities. Tax planning involves the structuring of taxpayers' books in a way that is tax efficient and ensure payment of minimal tax payable bearing in mind the provision of the tax laws. Tax advocacy arise when there is dispute between the taxpayer and the tax authority necessitating representation in court. A professional tax consultant can handle any or combination of these services for his client. In rendering the services to his client, a tax consultant should demonstrative high level of professionalism and competence.

23.2 Legal requirement for professional accountant in practice

In line with the professional code conduct issued by the Institute of Chartered Accountants of Nigeria, a Chartered Accountant in public practice should not engage in any business, occupation or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the rendering of professional services.

23.3 Client and engagement acceptance – (Communication with clients)

There is always the need for timely communication with clients on matters relating to appointment and acceptance of offer to act as tax consultant, as well as updates on representation to the tax authorities.

Taxpayers are of two categories:

i. Individual taxpayers ;and

ii. Corporate tax payers.

Both individual taxpayers and corporate taxpayers file tax returns to both State Internal Revenue Service (SIRS) and Federal Inland Revenue Service (FIRS).

It is, therefore, important that when appointing tax consultants, clients must specify the scope of assignment in the letter of engagement.

The tax consultants must also be guided in accepting any job and understand their obligations as tax agents, liaising between the clients, tax authorities and other third parties.

23.3.1 Appointment of a tax consultant

(a) Appointment of a tax consultant is usually communicated vide an appointment letter from the client to the tax consultant. Following this, the tax consultant will then issue a letter of engagement to the client spelling out the terms of the engagement including scope of work, deliverables, fees and payment terms.

(b) A typical letter of appointment, letter of acceptance and letter of introduction to tax office are as shown below:

Illustration 23.1

<u>Letter of appointment as tax consultant written on the letterhead of DDB Nigeria Ltd.</u>

23 April 2018

The Managing Partner XYZ Consultants
Mable House (5th Floor) 23, Broad Street
,Lagos.

Dear Sir,

Appointment as tax consultants

We refer to the discussion held recently with our directors on tax and related matters, we hereby confirm that management has approved your firm's appointment as tax consultants to our company with immediate effect.

Please note that the services to be rendered include, tax matters of employees, directors and the company.

You are to please liaise with our Financial Controller, who will provide you with all necessary information and financial statements / records which you might require in the course of carrying out the assignment.

We propose a meeting with you for Thursday, April 28, 2018, by 2 pm at our Surulere head office to finalise the details.

We look forward to a mutually-beneficial business relationship between our company and your organisation.

Yours faithfully,
for: **DDB Nigeria Ltd**

(Signed)
James Ikilo
Managing Director

23.3.2 Acceptance of offer as tax consultant

The acceptance of offer as tax consultant to a taxpayer is the indication of the readiness of the tax consultant to render the specific services requested and to provide other special assignments to the client(s) from time to time.

The consultant from inception should understand the nature and scope of the assignment in order to provide adequate services to the client(s). Issues relating to professional fees should be fully discussed at the inception of the contract for service.
Acceptance of offer must be communicated in writing to each client as illustrated below:

Illustration 23.2

<u>Specimen letter of acceptance on the letterhead of XYZ Consultants</u>

April 24, 2018

The Managing
Director DDB Nigeria
Limited
4, Brown
Road
Surulere,

Lagos.

Dear Sir,

Acceptance of offer as tax consultants

Your letter dated April 23, 2018, on the above subject refers.

We confirm our firm's acceptance of your offer to act as tax consultants to your organisation.

From the contents of your offer letter, we understand that we shall provide tax related advisory services to your company, its directors as well as its employees. We will also represent your interest with the relevant tax authorities from time to time.

We shall be pleased to meet with you as scheduled.

Thank you.

Yours faithfully,
for: XYZ Consultants

(Signed)
Apple Dior
Managing Partner

23.3.3 Introduction to tax authorities

Once the acceptance of offer to act as tax consultant has been concluded and the fees agreed, the next step is for the client to formally introduce the tax consultants to the relevant tax authorities. This introduction is usually done with a letter to the relevant tax authorities and the tax consultants will be copied in such letter, as illustrated below:

Illustration 23.3

Specimen letter of introduction to Federal Inland Revenue Serviceon the letterhead of DDB Nigeria Ltd

7 May 2018

The Tax Controller
Federal Inland Revenue Service
Surulere Mirco and Small Tax Office (MSTO)
5, Adeniran Ogunsanya Street
Surulere, Lagos

Dear Sir,

Appointment as tax consultants

This is to inform you that we have appointed XYZ Chartered Accountants as our Tax Consultants. Their office is located at Mable House (5th Floor), 23, Broad Street, Lagos.

The firm has been authorised to represent our company with respect to our tax matters in your office. Kindly extend to them your usual co- operation and support.

Yours faithfully,
for: **DDB NIGERIA LTD**

(Signed)
James Ikilo
Managing Director

cc:
The Managing Partner XYZ
Consultants
Mable House (5th floor), 23, Broad Street
Lagos.

Illustration 23.4

<u>Specimen letter of introduction to Lagos State Internal RevenueService on the letterhead of DDB Nigeria Ltd</u>

May 7, 2018

The Head of Station
Lagos State Internal Revenue Service
Surulere Tax Office
14, Bode Thomas Street
Surulere, Lagos

Dear Ma,

Appointment as tax consultants

This is to inform you that we have appointed XYZ CharteredAccountants as our tax consultants. Their office is located at Mable House (5th Floor), 23, Broad Street,Lagos.

The firm has been authorised to represent our company with respect to our tax matters in your office. Kindly extend to them your usual co- operation and support.

Yours faithfully,
for: **DDB NIGERIA LTD**

(Signed)
James Ikilo
Managing Director

cc:
The Managing Partner XYZ
Consultants
Mable House (5th floor), 23, Broad Street
Lagos.

Note: A similar letter of introduction should be written to each of the State Internal Revenue Services in Nigeria where the company have branches.

23.4 Client and engagement acceptance – (Communication with taxauthorities)

The tax authorities rely on documents and firsthand information provided by any taxpayer (or the tax consultant), in determining the possible tax liabilities of the taxpayer.

Additional information from third parties such as banks, insurers, landlords, tenants, suppliers, customers, shareholders, Registrar of Companies and other stakeholders may be required by the tax authorities for assessment purposes.

Under the provisions of the Federal Inland Revenue Service (Establishment) Act, 2007 and other tax legislations, relevant tax authorities have rights to receive or demand for additional information from taxpayers and third parties, on matters affecting any taxpayer. Communication with tax officials will usually cover the following:

a. Registration with tax authorities for Income and other taxes using standard questionnaires;

b. Filing of tax returns within time limits provided by the tax laws;

c. Self assessments and objections to best of judgment (BOJ) assessments; and

d. Tax queries and replies.
These are fully discussed below:

23.4.1 Registration with tax authorities

The Federal Inland Revenue Service and State Internal Revenue Service have a standard questionnaire which are expected to be completed by taxpayers for registration under the provisions of CITA, PITA, PPTA and other tax legislations/Acts.

The following details, together with Certified True Copies (CTC) of Incorporation documents (originals to be submitted for verification), will be provided in a formal letter addressed to the chairman of the relevant tax authority in respect of every prospective taxpayer:

(a) Name, Registration number and Date of incorporation/Registration.

(b) The registered or residential address (as applicable).

(c) The business address.

(d) Names and addresses of the directors.

(e) Names and addresses of the shareholders together with their shareholdings.

(f) Any other directorship held by the directors.

(g) The precise nature of business.

(h) Whether or not the business has any predecessor(s).

(i) The date of commencement of business.

(j) The accounting year-end.

(k) Details of Company Secretary (where applicable).

(l) Details of the appointed Auditors and Tax Consultants.

(m) Details of appointed Bankers.

(n) Any other information which may help the tax authority in this regard.

23.4.2 VAT registration

A vatable person or VAT agent is required to also file application for VAT registration at the nearest FIRS office. The application will be supported with CTC of the registration documents.

23.4.3 Filing of tax returns

Any company registered in Nigeria must submit relevant information to the tax authority within six months of the accounting year end. A new company must file its tax returns within 18 months of incorporation or 6 months after its first accounting period, whichever is earlier.

With respect to personal income tax, an Individual must also provide relevant information in the specified format (Form A) at the beginning of every assessment year.

Filing of tax returns for Individuals and corporate persons are done using prescribed self-assessment forms, with supporting documents.

The following are usually forwarded to FIRS as tax returns, within eighteen months of incorporation of the company or six months after the end of the accounting year-end (whichever is earlier):

(a) Signed audited financial statements together with a covering letter from the tax consultant;

(b) Capital allowances and income tax computation.

(c) Self-assessment forms for income and education tax.

(d) Evidence of payment of self-assessment tax computation

23.4.4 Due date for payment of tax

Payment of income tax is due on the filing date in case of a lump sum payment or in case of instalmental payment, as may be approved by the FIRS, not exceeding three instalments; in this case, evidence of first instalmental payment must be submitted along with the taxreturns.

23.4.5 Self-assessment for individuals

Tax returns for individuals are submitted at the beginning of every assessment year. The Self-assessment form (Form A) is completed, stating various sources of income and allowances/reliefs claimable. The assessment forms must be signed and dated by the taxpayer.

It is relevant to note here that tax payments to both FIRS and SIRS are now made vide e-payment at designated banks or electronic transfer from the taxpayer office. The e-payment has therefore reduced the level of written communication with
the tax authorities.

23.4.6 Best of judgment (BOJ) assessment

Where the taxpayer fails to file Self-assessment forms and pay the normal tax within the time limit specified under the law, BOJ assessment may be raised on the affected taxpayer.
A valid objection must be raised within 30 days of service of such notice, stating valid grounds of objection.

Illustration 23.5

Objection to BOJ assessment

ABC Limited is a trading company which has been operating in Nigeria for over ten years. The company is duly registered for both income tax and VAT and has been filing returns regularly.

Unfortunately, the company's accounts for the year ended 31 December 201, could not be signed by the directors until 1 August 2018, when the Managing Director returned from his medical trip abroad. A BOJ assessment for ₦4.5m was served on the company with date of service of 30 July 2018. The tax consultant filed and paid for self-assessment on 2 August 2018 as follows:

Income tax	₦2.75m
Education tax	₦260,000

The tax authority imposed a Late Returns Penalty (LRP) of ₦25,000 on
the company thereafter.

Required:
As a tax consultant with many years of experience, write a suitable letter of objection to the BOJ assessment to the tax office.

Suggested solution 23.5
8 August 2018
The Tax Controller
Federal Inland Revenue Service
Integrated Tax Office
No shaking Way,Ikeja

Dear Sir,

ABC Limited
TIN NO :21494422 – 0001

Objection to BOJ Assessment No YC/A/110/2018/1 dated 30 July 2018 for ₦4.5M

We write to raise a formal objection to the above quoted BOJ assessment of ₦4.5m raised on our above – named client, ABC Limited for 2018 assessment year.

Our grounds of objection are as follows:

(a) Our client has been a good corporate taxpayer and has been meeting its tax obligations over the years;

(b) The company's accounts were audited on time, but could not be signed by the directors until the end of July 2008, due to ill health of the Managing Director. Photocopies of his medical reports for treatment received in Toronto are attached for your perusal;

(c) The BOJ assessment was served on the company few days ago; and

(d) Tax returns and self-assessment form and payments for Income tax, Education tax and LRP were submitted to your office on 2 August 2008. Please see copies attached for ease of reference.

We will, therefore, be grateful if you would please discharge the BOJ assessment of ₦4.5 on compassionate ground and substitute with the self-assessment Returns for ₦2.75m based on the income tax computations already filed.

We sincerely thank you for your cooperation. Yours faithfully,
For: XYZ Consultants

Apple Dior
For: Managing Partner

CC:
The Managing Director
ABC Limited
4, Brown Road
Surulere, Lagos.

23.4.7 Tax queries and replies Queries

Tax queries emanate from desk examinations of tax returns by tax officials. Returns are examined, supporting documents are requested for in order to ascertain whether or not the taxpayer's income has not been understated, reliefs not overstated or that the expenses deducted from the income for the period, were ***"wholly, exclusively, necessarily and reasonably incurred"*** in the production of those incomes.

Tax queries may not follow any specific pattern, but tax practitioners must have a better understanding of the taxpayers' operations, and possess adequate technical know - how, with relevant field experience.

The following issues may be raised from related documents, collected or verified by tax officials, in order to eliminate any private or capital expenditure from the tax returns and also guide against tax avoidance to some reasonable extent:

(a) Whether there exists, supporting documents for assets, liabilities income and expenditure in the name of the taxpayer;

(b) Whether private expenses were included in the Accounts;

(c) Whether relevant documents such as certificate of acceptance, input VAT invoices, supporting invoices, premium claims, invoices on administrative and operating expenses, etc. agreed with amounts stated in the accounts;

(d) Whether PAYE deducted from salaries and withholding taxes from supplies or professional fees were promptly remitted;

(e) Whether capital expenditure in form of cost of increase in capital or incorporation expenses, general bad debts and depreciation have been written back to profit; and

(f) Whether losses and carry forward rules have been adequately observed.

Replies

When replying to tax queries, tax practitioners should endeavour to be ethical and use professional language as much as practicable. The consultant may quote decided cases or tax laws provided the circumstances or scenarios are similar.

Apart from the above, the consultant should make use of relevant supporting documents from both the client's office and his working papers. Third party documents not relevant to the queries raised should not be forwarded as an attachment.

Finally, the tax consultant should not be seen to be involved in any practices which could be construed to be tax evasion, fraud or outright criminality.

23.5 Client and engagement acceptance – (Communication with other stakeholders)

Communication with other stakeholders is specifically required to gather additional information on the clients' business.

23.5.1 Communication with former tax consultant and auditors

To satisfy professional ethics, an incoming tax consultant is required to liaise with the former consultant and/or auditors in charge of the client's tax matters.

In these circumstances, the incoming consultant needs to:

(a) Confirm whether or not there exists any professional reason(s)why they should not accept the appointment;

(b) Obtain relevant documents, audited accounts, tax computations and background information on the new assignment; and

(c) Plan the assignment.

23.5.2 Communication with others

The tax consultant may also need to obtain further information in respect of the client, from the following:

(a) Bankers - for bank statements in support of bank charges and to vouch certain entries;
(b) Insurers - for premium paid;
(c) Pension Fund Administrator - for pension fund certificate, to support exemptions; and
(d) Other professionals, that is, lawyers for legal advice.

The tax consultant must obtain written permission from the client in support of third parties' evidence. He should exercise the duty of reasonable care in making use of any third parties' evidence.

23.6 Client and engagement acceptance – (Clients documentation and records)

After accepting the offer to act as tax consultant to any taxpayer, necessary documentation and information should be put in place.

23.6.1 Documentation/information to be maintained/provided by clients

The company's (client's) officers should have the following document/records:

(a) Certificate of Incorporation;
(b) Certified True Copies (CTC) of Memorandum and Articles of Association (MEMAT);
(c) CTC of Forms on Directors (CAC 7), Allotment of Shares (CAC 2), Appointment of Secretary (CAC 2.1) and Notice of Registered office (CAC3);
(d) Certificate of increase in share capital including stamp duties, registration fees, board's resolution, etc.;
(e) Contracts, rents and of her agreements;
(f) Financial matters:
    (i) Signed audited financial statements;
    (ii) Books of account, ledgers, trial balance (hard &softcopies);
    (iii) Fixed assets register and title documents;
    (iv) Accounts and procedural manual;
    (v) Payment vouchers, receipts, etc;
    (vi) Banking & cash transaction documents; and
    (vii) Monthly payroll and directors' emolument.

(g) Correspondence with tax authorities and other third parties;
(h) Minutes of board of directors' and annual general meetings(AGM);
    (i) Tax and other payment receipts, assessments, forms, tax clearance certificates, etc.; and;
    (ii) Other financial and non-financial documents including appointment letters.

The above should be kept intact in a safe place, because they may be required for sighting by the Revenue Authorities, during registration, filing of assessments and tax examinations.

23.6.2 Documentation/data to be maintained by the tax consultant

The following documentation/data, among others, will be maintained by the tax consultants in respect of each client. The documents which will either be kept in the permanent file or forwarded to the relevant tax office will include the following:

(a) CTC of incorporation documents i.e. certificate of incorporation, MEMAT, details of directors (CAC 07), Shareholders, Secretary, Share Capital details, etc.;
(b) Engagement letter;
(c) Company auditors, if different from the tax consultant;
(d) Audited financial statements, capital allowances, income tax, education tax and other computations;
(e) Trial balance, detailed analysis and schedules on the financial statements;
(f) Correspondence with the client, tax authorities and third parties;
(g) Registration documents in respect of income tax, value added tax (VAT), PAYE, withholding tax and other levies;
(h) Records of billings and outstandings; and
(i) Other documents, financials and non-financials.

23.7 Risks of running a professional tax practice

Tax legislation is becoming increasingly complex; bringing ever more risk for the professional tax practitioners. Tax is a highly contested practice area in accounting profession. Statistics show that the highest volume and value of professional liability insurance (PLI) claims for small and mid-sized firms are related to tax services. With an increasingly complicated tax system, it is quite easy to see why tax is the top of the list when it comes to insurance claims and complaints. It is therefore crucial that practitioners take care when practicing tax, keeping up with the latest tax changes and implementing quality controls within their practice.

The following are the risks of running professional tax practice:

(1) **Lack of expertise**
This may lead to errors due to practitioners advising clients on technical tax matters when they didn't have adequate experience or knowledge. Examples include giving wrong professional opinion on tax matters, advise of tax implications of business arrangement and re-organisation or restructuring, etc

(2) **Lack of attention to detail**
This may lead to errors that could have been avoided if there had been procedures and controls in place. This include late filing of tax returns whose penalties is huge for clients

(3) **Lack of documentation**
Failing to maintain evidence of client engagement terms or tax filing positions in working paper files. This include failure to detect the client's non-compliance with certain tax laws when it was unclear whether the compliance to such tax laws was part of the tax practitioner's mandate (engagement letters are a key tool for reducing this sort of risk).

(4) **Unpredictable Income for Owners**

Owner's income can be unpredictable – Owners are responsible for the financial well-being of their employees and the last one to get paid is the owners. While others can mentally "check out" at the end of the work day, owner's brain is typically plugged into business.

Measures to mitigate the risks are:
1. Only take on work within your circle of competence

Tax practitioners can avoid many of these risks by only accepting work for which they have either adequate experience or the ability to outsource the work to qualified tax specialists.

2. Implement quality control systems in professional tax practice

Quality control systems can not only help you avoid common pitfalls and manage risk, they can also help you improve your practice effectiveness.

Other ideas to mitigate the risks include:
- ✓ **Use checklists:** A best practice for the practice is to create general tax preparation and review checklists for all of your staff to use;
- ✓ **Implementation of a task and deadline tracking system:** A task tracking system can help tax practitioner monitor client filings and meet their due dates;
- ✓ **Follow client acceptance practices:** Before taken on new clients, it's wise to determine their past filing history and any issues encountered with the relevant tax authorities and their past tax advisors;
- ✓ **Invest in education:** The Nigerian tax system is becoming complex and constantly changing, so the practice should continually invest in staff training;
- ✓ **Document all material advice in writing:** Client working paper files should always include records of filing positions taken as well as client correspondence confirming the relevant facts. When tax practitioners give their client material verbal advice, they should also document a summary of the discussion in case an issue arises later; and
- ✓ **Obtain professional valuations:** When related parties transact with each other in significant transactions including reorganizations, professional valuations should be obtained to avoid the significant risks associated with an unreasonable valuation. If the client doesn't want to obtain a valuation, tax practitioners should decide on whether the work should be done at all. At a minimum, the risks should be communicated and documented in their working paper files.

Most importantly, tax practitioners should keep tax risk top of mind and make tax risk management a top priority as they run their day-to-day practice.

23.8 Benefits of running a professional tax practice

The following are some of the benefits of running a professional tax practice:

(1) **Own schedule and rules**

One of the biggest advantages of practice ownership is the ability to make your own schedule working whenever, wherever. Owning your own firm means you are better able to balance work, family and play. To accomplish this, you need to have good procedures in place for your staff, your clients, and, yes, even for yourself.

(2) **Financial benefits**

While your income can be unpredictable, that's not necessarily a bad thing if you are profitable. As a practice owner, you get to decide what you never would have been able to decide as an employee:

how much of the funds to retain in the firm and how much to bonus out. This means more money in your pocket.

(3) **You pick your own team**
Your success as a practice owner is immensely dependent on your team. As an employee sometimes you can get stuck working with people that are not productive or simply not very nice. With ownership comes the benefit of choosing people that will fit the firm culture and will help it prosper. This is also very important in order to make possible all of the above listed benefits. As an owner of your own practice, you get to choose who to hire and what type of environment you want to have at work.

(4) **Opportunity to pick own clients**
Although many practice owners don't take advantage of this benefit, they really should because they are not limited to just picking specific industries.

It is also very important that your clients fit your culture, i.e., if you are a technology driven firm, you don't have to accept clients who loathe technology and handle everything through paper copies. When creating a desired culture, it is advantageous to accept only clients who fit that culture. Detouring from that creates inefficiencies and disadvantages for you, your team and the clients.

(5) **You create your own vision**
As a practice owner, you are also the vision owner. The key to the success of the practice goes back to setting rules, picking the right team, and the right clients. These things are not necessarily easy to achieve, but for a practice owner, unlike for an employee, they are very much possible.

23.9 Submission of objection letter via electronic and physical means

Prior to implementation of Finance Act, 2019 and Finance Act, 2020, the mode of submission of objection letter and assessment is by physical means in line with the provisions of Personal Income Tax Act (PITA) and Companies Income Tax Act (CITA).

In line with the provisions of Finance Act, 2019, sections 57 and 58 of PITA has been amended with respect to service of notice of assessment and objections. The Finance Act, 2019 now permits the use of electronic means to exchange correspondences between the States Internal Revenue Service and the taxpayers.

In a similar manner, the provisions of Finance Act, 2020, sections 68 and 69 of CITA have been amended with respect to service of notice of assessment and objections. The Finance Act, 2020 now permits the use of electronic means to exchange correspondences between the Federal Inland Revenue Service and the taxpayers.

23.10 The role of technology in running a contemporary tax practice

The role of technology in running a contemporary tax practice is changing rapidly. The tax ecosystem is currently at a turning point because the tax practice itself is currently faced with a wide range of issues, new layers of complexity and regulatory pressure.

A new synthesis between taxation and technology is emerging and is establishing a new taxation parading that has been adopted by enterprise organizations and small businesses alike.

The new frontier of taxation is the digital realm. The adoption of digital tax accounting practices is a highly disruptive trend that brings real-time analytics, real-time access, and enhanced visibility to business owners and tax consultants.

Tax legislations are being amended in recognition of the role of technology as it affects digital transactions and mode of correspondences between the tax authority and the taxpayers.

Application of technology in tax administration creates the following advantages to taxpayers:

Ease of doing business: Automation will enable taxpayers reduce or minimize cost of compliance and boost their ease of doing business
Cost saving : Automation saves cost for taxpayers in terms of time and money spent where there is no automation
Efficiency : With Automation, there is general improvement in efficiency.
Health: Automation enables the taxpayer to safely comply with his tax obligation without risking or compromising health of individuals in the event of a pandemic when physical contact will be restricted.

Roles of technology in tax practice include:

i. With the use technology applications such as cloud accounting, the tax practicesare able to take advantage of powerful taxation software and services based on remote servers. This enhances the ability of the practice to share financial data with team members regardless of location or time zone.

ii. Cloud accounting and other technology-driven tax solutions deliver a wide range of benefits to tax practice regardless of size. The primary benefit offered by cloud accounting is the ability to automate otherwise time-consuming tasks.

iii. Modern tax technology is able to assist with the complex nature of cryptocurrency tax reporting. Major cryptocurrency exchanges can work to keep customer data extremely secure and private, which can make it difficult to track trades for capital gains or income tax reporting. By providing cryptocurrency-specific tools, cloud-based taxation technology establishes a future-proof foundation for cryptocurrency adoption and tax strategy.

iv. Cloud-based tax practice keeps data safe with enterprise-scale security, eliminating the threat of data breaches. Data breaches are extremely costly for practice of all sizes. Both large and small-scale tax practice are often the target of hackers that attempt to steal sensitive client's data.
Therefore, to cope with continuous changes in tax landscape, tax practice firm needs to invest heavily in technology to enhance their services offering to their clients.

23.11 Tax authorities code of ethics

The administration of companies income tax and personal income tax in Nigeria is vested in the Federal Inland Revenue Service Board and the State Internal Revenue Service Board respectively. The officials of these relevant tax authorities are expected to follow the following code of ethics, work by it, teach it and live by it.

a. **Discipline:** All officers must be well disciplined. Rules and regulations must be adhered to senior officers must show good examples for the junior ones to follow.

b**. Loyalty:** All officers must be loyal to the government. They must give good and adequate service in return for their salaries.

c. **Honesty:** Officers should be honest in the performance of their duties. They should bear in mind that their salaries are paid, for the duties they perform and hence, they should not demand or receive something, that is, either in cash or in kind from anyone in the discharge of their official duties.

d. **Courage:** Every officer is expected to be courageous in the performance of his/her duty and to work hard and accept challenges of a busy office. They must do what is morally right which automatically enhances the reputation of the Officers and the Service.

e. **Courtesy:** Officers must be polite to colleagues, especially to members of the public, as polite instructions are generally easier to be obeyed and complied with. The members of the public generally cherish courteous treatment.

f. **Tact:** Officers must be very skillful in handling/dealing with difficult situations without offending those involved. This is especially necessary in the tax office. Other ethical issues include cooperation, avoidance of delay, industry tidiness, kindness, efficiency, good attitude to public and national consciousness.

23.12 Confidentiality

The officers of relevant tax authorities as well as tax consultants should respect the confidentiality of information acquired as a result of tax administration and practice and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the tax practitioners.

Penalty for failure to fulfill obligation of secrecy/confidentiality

An officer of the relevant tax authority shall treat all documents, information and returns and all matters relating to the taxpayers asconfidential. A person shall be guilty of an offence under the obligation of secrecy if he communicates or attempts to communicate such taxpayer’s information to another person. Failure to fulfill obligation of secrecy may lead to dismissal.

Conditions when information on taxpayers may be disclosed

The need to comply with the principle of confidentiality continues even after the end of relationships between a tax practitioner and a client. When a tax practitioner engagement with a client ends or is engaged by a new client, the tax practitioner is entitled to use prior experience. However, he shall not use or disclose any confidential information either acquired or received as a result of a professional relationship with the previous client because doing so may tantamount to professional misdemeanor and consequence could be very costly.

Nonetheless, there are instances when a tax consultant may disclose information on a client (whether past or present). The following are circumstances where a tax consultant may disclose information on a taxpayer when:

(a) Disclosure is permitted by law;
(b) Disclosure is authorized by the client, that is, the taxpayer;
(c) Disclosure is required by law, for example;
  (i) Production of documents or other provision of evidence in the course of legal proceedings; or
  (ii) Disclosure to the appropriate public authorities of infringements of the law that come to light; and
(d) There is a professional duty or right to disclose, when not prohibited by law; for example;
  (i) To respond to an inquiry or investigation by a member body or regulatory body such as ICAN, CITN, etc.;
  (ii) To protect the professional interests of a professional body, that is, ICAN, CITN, etc. in legal proceedings; or

(iii) To comply with technical standards and ethics requirements.

23.13 Conflict of interest

A tax practitioner is not expected to act for two opposing parties. A tax practitioner may be faced with a conflict of interest when undertaking a professional activity. A conflict of interest creates a threat to objectivity and may create threats to the other fundamental principles. Such threats may be created when:

(a) The tax practitioner undertakes a professional activity related to a particular matter for two or more clients whose interests with respect to that matter are in conflict; or

(b) The interests of the tax practitioner with respect to a particular matter and the interests of a client for whom the tax practitioner undertakes a professional activity related to that matter are in conflict.

What a tax practitioner should do when there is conflict of interest

i. A tax practitioner may be required to resolve a conflict by complying with the fundamental principles.
ii. It may be in the best interests of the tax practitioner to document the substance of the issue, the details of any discussions held, and the decisions made concerning that issue.
iii. If a significant conflict cannot be resolved, a tax practitioner may consider obtaining professional advice from the relevant professional body, that is, ICAN and or CITN. The tax practitioner generally can obtain guidance on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed with the relevant professional body on an anonymous basis or with a legal advisor under the protection of legal privilege.
iv. If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a tax practitioner shall, where possible, refuse to remain associated with the matter creating the conflict. The tax practitioner shall determine whether, in the circumstances, it is appropriate to withdraw from the specific assignment or client.

23.14 Chapter review

In this chapter, readers must have learnt the following:

- The processes of tax consultants' engagement;
- Various forms of communication between the tax consultants and its clients;
- Various forms of communication between the tax consultants and the relevant tax authorities;
- Nature of services that tax consultants could render to its clients;
- Types of documents to be kept by both client and tax consultants in the course of engagement; and
- Ethical issues as regards taxpayers and tax matters on non- disclosure to unauthorised persons. Oath of secrecy in the Civil Service and a body of "Code of Ethics" for civil servants.

23.15 Worked examples

23.15.1 Open-ended questions

(1) James Bond Nigeria Limited, based in Ibadan was incorporated in January 2012, as a

producer of wallets and other safe keeping products. The first set of audited accounts was for the year ended 31 December 2012 and it was filed by Messrs F.J. Yaba & Co. to the relevant tax authority together with the tax computations.

Upon examination of the tax returns, the Tax Controller raised some queries relating to the following expenses:

(i) Bank charges;

(ii) Electricity expenses;

(iii) Hotel expenses;

(iv) Cost of equipment;

(v) Building costs;

(vi) Purchase of raw materials;

(vii) Salaries and wages;

(viii) Directors' fees;

(ix) Business insurances; and

(x) Rent.

Required:
Assuming you are the Tax Controller, do a letter to the Tax Consultants of the company requesting for the relevant documents to support the various expenses noted above.

(2) An Ibadan based textile manufacturer - Deptec Ventures Nigeria Limited - was incorporated on 1 July 2011, but commenced business in January2013.

The financial year-end of the company is 31 December. The Board of Deptec Ventures Nigeria Limited has just appointed your firm as the company's external auditors and you have been duly informed.

Assume that the necessary audited accounts have been prepared by your firm in accordance with the provisions of the relevant laws and accounting standards.

Required:
Draft a letter addressed to the appropriate tax authority stating the following:

(a) The audited financial statements attached, in accordance with the provisions of the Companies and Allied Matters Act, CAP C20, LFN 2004 (as amended);

(b) Tax computation for relevant year of assessment; and

(c) Any other information required to accompany the first set of returns as an agent of Deptec Ventures Nigeria limited.

(3) Eye Service Limited was incorporated as a limited liability company on 25 February 2012. The major object clause of the company as stated in its Memorandum of Association is "to carry out Eye Services generally". It has an Authorised Share Capital of ₦1,000,000 ordinary shares of ₦1.00, fullyallotted to the three subscribers, who are also the founding directors as stated in the incorporation documents presented to you.

You have just been appointed as the first Tax Consultants to the company, which has its registered and business address at 22c, Crossroads Lane, Idumota, Lagos. The company commenced operations at exactly 2 pm on Monday, 4 May 2012.

Required:
Draft suitable letters to the appropriate tax office for income tax and VAT registration purposes.

(4) The success achieved by Federal Inland Revenue Service (FIRS) in meeting the revenue targets set for its Integrated Tax offices nationwide was seen as a challenge by its state counterpart, i.e. State Internal Revenue Service (SIRS). As a result, the Chairman of New State Board of Internal Revenue, in a bid to increase the revenue drive from the self-employed category, announced various incentives to staff who are able to meet the targets set.

You have been engaged as the Tax Consultant to the Chairman of New State Internal Revenue Service.

Required:
Advise the Chairman of New State Board of Internal Revenue in:

(a) Identifying constraints facing the tax authorities in the assessment and collection of taxes from self-employed taxpayers; and
(b) Evolving strategies for expanding the Nigerian tax net to improve tax collection from the self-employed category of taxpayers.

23.15.2 Suggested solutions to open-ended questions

(1) **Letterhead of the Tax Office**

Our reference (O/R) Your reference (Y/R)

18 October 2013

The Tax Partner
Messrs F. J. Yaba & Co.
Tolulope Street
Molete, Ibadan.

Dear Sir,

James Bond Nigeria Limited

Re: Audited Financial Statements for the Year Ended December 31, 2012

We refer to the tax returns filed on behalf of your client, for the year ended 31 December 2012, together with the tax computations for 2012 and 2013 Years of assessments.

Having examined the accounts and the accompanying schedules, it becomes highly imperative to seek for more clarifications on some of the expenses incurred by your client. To this end, we hereby request for some documents evidencing the various expenses as follows:

(a) **Bank charges**
Give details of your client's bankers and provide us with all the bank statements from January to December 2012.

(b) **Electricity expenses**
Forward copies of all electricity bills and evidence of payment for the year under review.

(c) **Hotel expenses**
All hotel bills for the year under review are needed.

(d) **Cost of equipment**
All invoices and receipts evidencing payments and delivery of the equipment to be submitted.

(e) **Building costs**
Building plan, survey plan, receipts and invoices, vouchers, certificate of occupancy, architect's certificates are needed.

(f) **Purchase of raw materials**
Receipts and invoices, Goods Received Notes, waybills and stock cards are required.

(g) **Salaries and Wages**
Staff payroll, evidence of remittance of PAYE and appointment letters are required.

(h) **Directors' fees**
Forward evidence of withholding tax deducted and remitted to the relevant tax authorities and vouchers for payments of directors' fees.

(i) **Business insurances**
Insurance policies, receipts issued by insurance companies and claims received, if any, are to be submitted.

(j) **Rent**
Rent agreements, receipt issued by the landlord, evidence of deduction and payment of Withholding tax and vouchers are required.

It is our hope that you will expedite action in this regard by providing all the above documents without delay. Kindly respond to our queries within 30 days after the date of receipt of this letter.

Thanks for your anticipated cooperation

Yours faithfully,
for: Ibadan Medium Tax Office

J. O. AGBELOBA
Tax Controller

(2) **XYZ &Co. (Chartered Accountants)**
Plot 10, Oke-Ado Street, Ibadan.

The Tax Controller
Federal Inland Revenue Service Ibadan Medium Tax office Ibadan.

Dear Sir,

DEPTEC Ventures Nigeria Limited

1 October 2014

Registration of the Company for Tax Purposes

We wish to inform you that we have been appointed as the external auditors to the above-named company and we also have instructions to file all necessary documents with your office.

Please find enclosed herewith, copies of the statement of affairs for the period ended December 31, 2012 (18 months) and audited financial statements for year ended December 31 2013. Also included, are the copies of the relevant tax computations for 2013 and 2014 years of assessment, completed self-assessment forms and evidence of payment of self-assessed tax liabilities.

The following documents/information are supplied for record purposes:

(a) A reply to your questionnaires;

(b) Names and addresses of directors;

(c) Copy of the Memorandum and Articles of Association;

(d) Copy of the Certificate of incorporation (original available for sighting);

(e) Copy of the form, containing the particulars of directors duly stamped by the Corporate Affairs Commission;

(f) Accounting year-end is December 31, every year;

(g) Letters of appointment of our firm as the external auditors and tax consultants addressed to you, by our client;

(h) Date of commencement of business – January 2013;

(i) The company manufactures textiles ;and

(j) The company's registered address is 2, Ajanlekoko Street, Oke Ado, Ibadan.

Kindly update our client's tax records accordingly.

We thank you for your usual co-operation in this regard.

Yours faithfully For:
XYZ & Co.

James Jaiyesimi
Managing Partner

cc:
The Managing Director
Deptec Ventures Nigeria Limited
12, Oke – Bola Road
Ibadan

3 (a) **XYZ & Company (Chartered Accountants)**
3, Lane Avenue, Lagos

O/R: FIRS/IT/12/01 Your reference (Y/R):

6 May2012.

The Tax Controller
Federal Inland Revenue Service
Idumota Medium Tax Office
4, Idumota Road
Lagos.

Dear Sir,

Eye Service Limited (Rc: 105449)

Application for Registration for Income Tax Purposes

We wish to register the above-named company for income tax purposes. The following information / documents which will enable you open a tax file are as follows:

1. The company was incorporated on 25 February2012.

2. The registered and business address of the Company is 22C, Crossroads Lane, Idumota, Lagos.

3. The Company is in the business of providing Eye Services,

4. The Company commenced business on 4 May2012.

5. The accounting year-end is 31 December each year.

6. The appointed banker is Long-Time Bank Ltd., 40, Idumota Road, Lagos.

7. The particulars of the shareholders are as follows:

Names	No of Shares Held
(a) Mr. Dindi Moloko	700,000
(b) Chief (Mrs)Tina Moloko	150,000
(c) Mrs. Sundie Moloko	150,000
	1,000,000

8. The Directors and their addresses are:

Name **Address**

Mr.Dindi Moloko -15, Moloko Way, Dolphin Estate, Ikoyi, Lagos. Chief (Mrs) Tina Moloko -15, Moloko Way, Dolphin Estate, Ikoyi, Lagos. Mrs. SundieMoloko -15, Moloko Way, Dolphin Estate, Ikoyi, Lagos.

9. The Directors have no other directorship.
10. The appointed auditors/tax consultant is: Messrs XYZ & Company
    3, Full-time Road
    Ikeja, Lagos.

The certified true copies (CTC) of the certificate of incorporation, Memorandum and Articles of Association, Directors and Shares Allotment forms are attached herewith. The originals of these documents will be presented to you for sighting.

The letter of introduction of the newly appointed auditors / tax consultants is attached for your records.

Thanks for your anticipated assistance.

Yours faithfully,
for: XYZ & Company

James Ahmadu
for: Managing Partner

cc: The Managing Director Eye
Service Limited
22c, Crossroads Lane
Idumota, Lagos

3 (b) **XYZ & Company (Chartered Accountants) 3, Lane Avenue, Lagos.**

Our reference (O/R) Your reference (Y/R)

6 May2012

The Tax Controller
Federal Inland Revenue Service
Idumota Integrated Tax Office
4, Idumota Road
Lagos.

Dear Sir,

Eye Service Limited
Application for VAT Registration

We wish to register the above-named company for VAT purposes.

The registered address of the company is 22C, Crossroads Lane, Idumota, Lagos.

Please find enclosed herewith, a copy of the certificate of incorporation of the company, completed, signed and stamped VAT registration form and a letter of appointment of the tax consultants.

Thanking you for your anticipated assistance.

Yours faithfully,
for: XYZ & Company

James Ahmadu
for: Managing Partner

cc: The Managing Director Eye
Service Limited 22c,
Crossroads Lane Idumota
Lagos.

(4) **ABC & Co. (Chartered Accountants)**
11 Edith Muhammad Street Ojodu,
Lagos.

Our reference (O/R) Your reference (Y/R)

25 May 2013

The Chairman
New State Board of Internal Revenue Lagos
Nigeria.

Dear Sir,

Re: Assessment and Collection of Taxes from Self-Employed Taxpayers

We refer to our recent appointment as Consultant to New State Internal Revenue Service for the purpose of providing an advisory service on the above subject and would like to comment as follows:

Self-employed taxpayers are unincorporated individuals or body of individuals engaged in their own businesses either as Sole Traders or in Partnerships. Such persons include individual contractors, traders, professionals, consultants, market men and women, artisans and all other entities that are not liable to tax under the Companies Income Tax Act, but under the Personal Income Tax Act. This means such persons are taxable on Income accruing to them personally.

All self-employed taxpayers are required to file self-assessment tax returns with the relevant state tax authorities every year. Such tax return is expected to disclose transactions relating to the individual's income for the year.

(a) Constraints being faced by tax authorities in assessing and collecting taxes from self-employed taxpayers include:

(i) **Lack of taxpayers' data /information**
There is no detailed information on or database for the self-employed in Nigeria, thus bringing them into the tax net is difficult;

(ii) **Inefficient utilization of tax revenue**
There is a general apathy to voluntary compliance with the provisions of the tax laws because of the level of decay in basic infrastructure which has always called to question the need for continued payment of tax in Nigeria;

(iii) **Tax evasion and avoidance**
It is easier for self-employed persons to evade tax than employees whose incomes are taxed at source. Also self- employed persons have evolved several tax avoidance strategies which require anti-avoidance provisions;

(iv) **Lack of experience and suitable qualified personnel** There is the dearth of experienced tax personnel, hence the difficulty in ascertaining the correct assessments for self-employed taxpayers;

(v) **Inadequate penalties / absence of enforcement**
In Nigeria, the penalties for non-compliance with relevant tax provisions are too lenient to compel the self-employed to pay tax. There is also a general lack of enforcement of existing penalties;

(vi) **Inadequate records**
Most self-employed persons do not maintain records of their income and expenditure. Some also mix their business activities with their private affairs, thus making it difficult to determine the income taxable;

(vii) **Lack of public enlightenment**
Most taxpayers do not know what tax to pay, when to pay, who to pay to, where to pay and what reliefs and allowances they are entitled to. A good tax system should be certain and easy to administer. The public should be educated on their responsibility with respect to tax at all times;

(viii) **Level of corruption**
Some tax officials collude with would-be taxpayers to defraud the government of taxes;

(ix) **Level of poverty**
Several self-employed persons are struggling to survive due to the unconducive operating environment. The society has been impoverished such that paying tax may further impoverish the low-income earners; and

(x) The over-dependence on oil revenue for a very long time has led to the neglect of all other non-oil revenue sources.

(b) Strategies for expanding the Nigerian tax net to improve tax collection drive covering the self-employed.

Having enumerated the constraints facing the tax authorities in assessment and collection of taxes from the self-employed taxpayers, the following strategies can be adopted to enhance compliance by self-employed taxpayers.

(i) **Public enlightenment an deduction**
The Revenue should embark on aggressive publicity and education of taxpayers on the various taxes payable by all self-employed individuals.

(ii) **Enforcement of withholding tax provision**
By further encouraging companies to implement the withholding tax provision, more self-employed persons who render various services to companies can be brought into the 'tax net'.

(iii) **Requirement for presentation of tax clearance certificate (TCC)**
By providing and insisting that TCC be produced for any form of transaction with government, more self-employed persons will be compelled to pay

their taxes.

(iv) **Stiffer penalties for non-compliance**
If the consequences of failure to comply with the provisions of the tax laws are made stiffer, more taxpayers will willingly comply with the tax laws.

(v) **Encouragement of cooperative unions**
By encouraging artisans in particular, to form associations through which government can reach the members, improvement in tax revenue generation from that category of self-employed persons will be achieved.

(vi) **Effective utilization of tax revenue**
Improvement in the level of basic infrastructural facilities will encourage voluntary compliance with provisions of the tax laws as they will show that the tax revenue is being utilised effectively.

(vii) **Promulgation of anti-avoidance provision**
Making provisions to block the several loop holes in the tax laws will enhance further compliance with the tax laws and increase tax revenue.

(viii) **Use of information technology**
The use of appropriate information technology that will make it difficult to evade tax will enhance tax revenue from self-employed taxpayers.

(ix) **Investigation and intelligence unit**
The investigation and intelligence units of the Revenue should be vibrant and effective. It is the responsibility of these units to trace self-employed persons in the society, who have not been paying their taxes. This can be done by going through the Land Registry and Vehicle Licencing Offices. Information can also be obtained from banks by insisting that they should file returns of all their new customers with the Revenue.

(x) **Engagement of experienced and qualified personnel** Employing qualified personnel and paying competitive remuneration will further enhance dedication to duty and ultimately increase tax revenue.

(xi) **Regular amendment to the tax laws**
The tax laws should be regularly updated and the provisions should be such that are reasonable and easy to comply with. Most of the provisions of the Nigerian tax laws are outdated and which makes it difficult to comply with. Some of those provisions encourage tax evasion.

Please do not hesitate to contact the undersigned, should you require further clarifications.

Yours faithfully,
for: ABC & Co.

Oki Ahmed
Managing Partner

24

Tax planning, avoidance and evasion

Contents

Tax planning, avoidance and evasion

24.0 Purpose

After studying this chapter, readers should be able to:

(a) Understand tax planning;

(b) Understand tax evasion;
(c) Understand tax avoidance;
(d) Be able to distinguish between tax avoidance and tax evasion;
(e) Understand other tax mitigation or tax planning issues; and
(f) Be Able to advise on tax planning activities and strategies

24.1 Tax planning

The main taxes in Nigeria can be classified into direct and indirect taxes as follows:

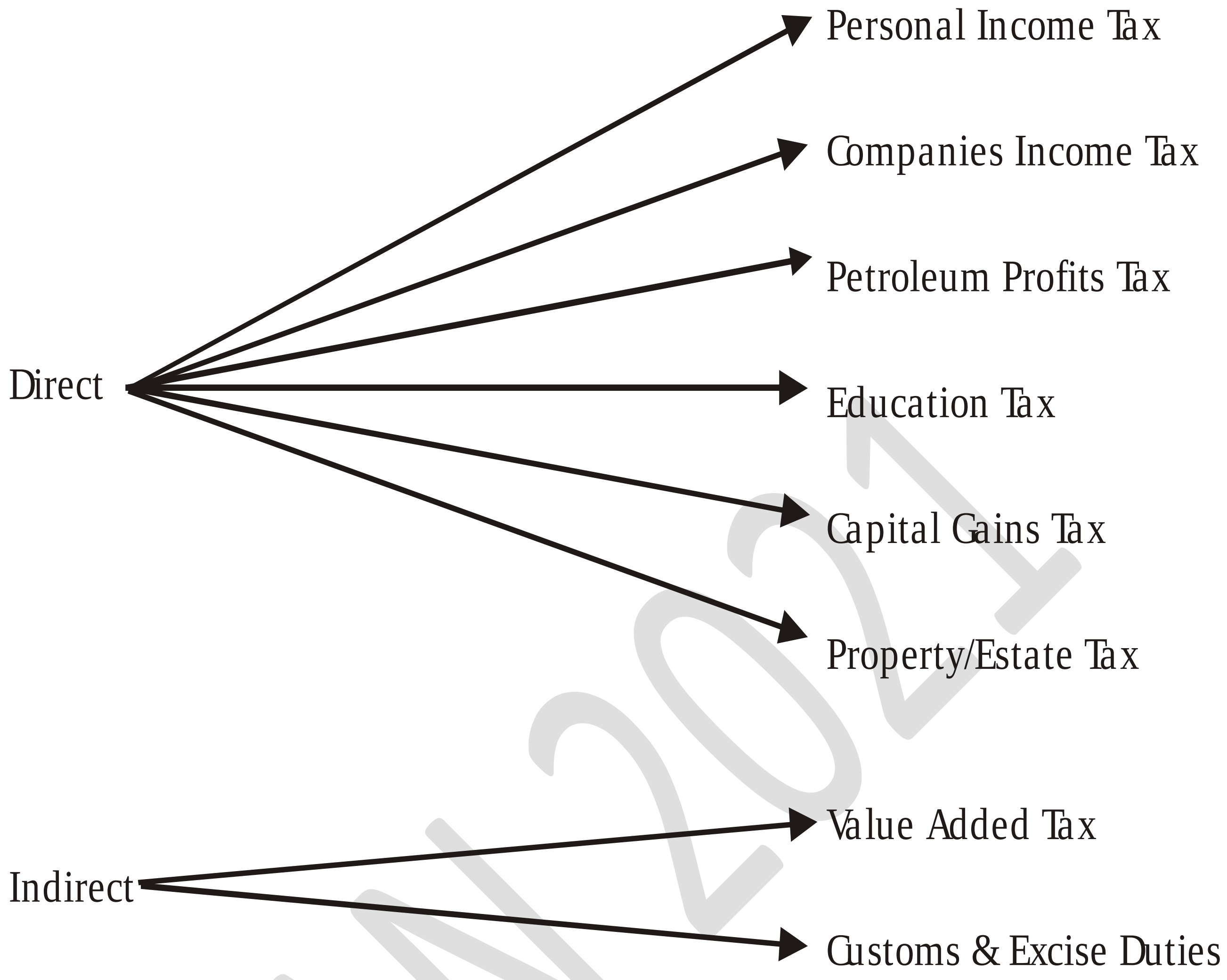
Direct taxes

These are charged on a taxpayer's income, profits or other gains. They are paid by the taxpayer directly to the tax authority. The direct taxes are Personal Income Tax (payable by individuals), Companies income tax (payable by companies other than those engaged in petroleum operations), Petroleum Profits Tax is payable by companies engaged in petroleum operations, Education tax is payable by companies, whilst Capital Gains tax is payable by both individuals and corporate bodies.

24.1.1 Indirect taxes

Indirect taxes are taxes imposed on commodities (goods), professional services and instruments, before they reach the ultimate consumer, client or owner respectively and are paid by them, not as taxes (i.e. not to the tax authorities), but as part of the selling/legalisation price/cost, of the commodity, service or instrument, as the case may be. Examples of indirect taxes include: Value Added Tax, Custom Duties, Excise Duties and Stamp Duties.

A simple guide to determining what tax is indirect is to acknowledge the fact that once the tax burden is not borne directly by the entity that remits the tax to the relevant tax authority, then it is an indirect tax.



Tax planning involves taking conscious efforts to consider the tax that will be payable by a taxpayer at a future date and how such tax can be minimised. It is clear that payment of tax is an outflow from the viewpoint of a taxpayer. With respect to profits/income tax, the amount that can be retained by the taxpayer from the profits/income of his business/ investments is reduced by the amount of tax that such taxpayer has to pay. Payment of tax in any country is regulated by the laws of the country. It is a statutory obligation that everyone has to comply with.

Stiff penalties, including imprisonment terms are usually in place in the tax legislation of each country to ensure that the taxes are paid. Since legally and morally, there may not be any way out other than to pay the tax stipulated by the laws of the country, it has been the consensus from the days of old, that taxpayers are not under any obligation to pay more tax than is necessary. Consequently, taxpayers have resorted to devising several means of ensuring that they pay the minimum possible tax.

Tax planning involves anticipating a set of circumstances and the identification of opportunities to minimise or defer tax liabilities within the law. It involves arranging affairs to ensure that the maximum allowances, exemptions and reliefs are enjoyed. Consideration would be given to the likely effect on the tax liabilities, of the timing of fixed assets acquisitions and disposals. The choice of the accounting date of a business entity can also have a significant effect on the tax payable by that business.

The impact of the commencement rules in the tax legislation, of taxable profits of the taxpayer, ought to be considered in tax planning, before deciding on the taxpayer's accounting date.

Planning with regard to the time that the profit is earned and the timing of the payment of the applicable tax on such profit, could result in significant financial advantage to a continuing business. When a business ceases to trade permanently, the date of cessation can also impact the amount of its tax liability. In tax planning, the tax-conscious business person and the expert tax adviser, working together, can very often significantly reduce the tax liability that would be otherwise payable.

Tax planning requires detailed knowledge of tax legislation and its application to particular circumstances, identifying and taking advantage of loopholes, if any. It should also be noted that tax planning involves taking note of the applicable taxation legislation, to ensure that the tax laws are properly complied with by taxpayers, such that all taxes due are paid as at when due.

24.1.2 Tax planning check list

The matters in the under-listed checklist should be considered while planning tax:

(a) List of approved taxes and levies;

(b) Timing of fixed assets acquisition;

(c) Timing of fixed assets disposals;

(d) Timing of capital allowances claim and amount to claim;

(e) Hire of assets as alternative to outright purchase – full hire charge is tax deductible;

(f) Where to invest;

(g) Making specific instead of general provisions;

(h) PAYE properly deducted'

(i) Withholding tax properly deducted;

(j) Note Critical Dates:

   (i) Filing of Tax Returns;

   (ii) Filing of Notice of Objection;

   (iii) PAYE Monthly Remittances;

   (iv) PAYE Year-end Returns and Final Payment;

(v) Withholding Tax Remittances to Revenue;

(vi) VAT Returns and Remittances to Revenue;

(vii) Nigeria Social Insurance Trust Fund(NSITF);

(viii) National Housing Fund (NHF); and Due dates for income tax payment, to avoid penalty and interest.

(k) In Capital Gains Tax (CGT), consider Roll-over Relief;

(l) CGT Rate is 10%. Stocks and Shares are exempted from CGT;

(m) Consider current tax incentives:

(i) Pioneer companies;

(ii) Rural investment allowance;

(iii) Investment tax credit;

(iv) Export processing zone allowance;

(v) Export free zone exempt profit;

(vi) Exempt profit of solid minerals mining;

(vii) Investment tax credit – spare parts fabrication;

(viii) Investment tax credit – replacement of obsolete plant;

(ix) Gas industry incentives;

(x) Road Construction and Refurbishment Tax Credit Scheme;

(n) Consider exempt income and profits (Section 19CITA).

(o) Investment options – low or no tax investment opportunities.

(p) Dividend distribution out of Franked Investment Income;

(q) Employees remuneration structuring ;and
Consider the effects of benefits in kind on taxable remuneration.

24.2 Taxe vasion

Tax evasion is a contravention of tax laws whereby a taxable person neglects to pay the tax due or reduces the tax liability by making fraudulent or untrue claims on the income tax forms or returns. Put differently, tax evasion is the act whereby the taxpayer achieve minimisation of tax paid through illegal means. Tax evasion involves outright fraud and deceit, for example, through deliberate omission of a source of the taxpayer's income from his return or deliberate understatement of income.

In Nigeria, tax evasion on a large scale is through failure to render tax returns. Tax evasion may be achieved by:

24.2.1 Understating income,

24.2.2 Overstating expenditure,

24.2.3 Making false claims for allowances and reliefs ,and

24.2.4 Omission of chargeable income from tax returns.

Tax evasion is usually more prevalent when the tax system is perceived to be unfair. Lack of transparency in governance may also encourage tax evasion.

The Revenue Service views any case of tax evasion seriously. If discovered, the Revenue Service will go further to reopen the relevant assessments beyond the normal statutory limit of six years. A tax evader may be charged to court for criminal offences with the consequent fines, penalties and, at times, imprisonment. However, unless the amount involved is large and the taxpayer is unwilling to cooperate, the Revenue Service will usually resort to out-of-court settlement with a lump sum payment by the taxpayer in settlement of the tax and penalty that would have been lost if the evasion was not discovered.

24.3 Tax avoidance

Tax avoidance arises in a situation where the taxpayer arranges his financial affairs in a form that would make him pay the least possible amount of tax. For example, avoidance of Value Added Tax can be achieved by anyone that does not buy the goods and/or services on which VAT is levied. Apart from boycotting the goods or services, tax avoidance schemes are carried out after a critical review of the tax laws. The taxpayer would then implement devices to exploit loopholes in the tax laws that would enable him avoid or minimise tax. It should be noted that to a very large extent, tax avoidance is legal once it is done within the limits permissible by the tax laws.The dictum established by the lord President (Lord Clyde) in the case Ayrshire Pullman Motor Services and David M. Ritchie v. C.I.R. several years ago still holds good. The lord President's statement is reproduced as follows:

"No man in this country is under the smallest obligation, moral or otherwise, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow – and quite rightly

– to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer is in like manner entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue."

In Federal Service of Inland Revenue v. American International Insurance Company (Nig.) Plc, Belgore C. J. stated:

"Tax is an obligation, not a duty. One is not a bad citizen if one can organise his business or trade in a legal manner to minimise his tax liability. He could and he should resist within legal means any unduly wide interpretation or unconventional implication of legislative intent of a tax law that might increase that burden. He can do so without being ashamed of walking in the street as a patriotic citizen. A shrewd business acumen and a legitimate protection of sweat of labour are not dishonest acts or an act having any moral turpitude. It is being pragmatic and practical. Being capitalistic might leave much to be desired, but among what is left is not illegality."

When tax avoidance schemes are stretched to the limit, transactions would be seen only in mere form and lacking in substance. This will be because such transactions were entered into just for tax avoidance purposes. There may be no commercial effect. When this signal is present, the Revenue Service would want to step in to disallow such transactions.

To the extent that no tax law would be contravened in several tax avoidance schemes, tax avoidance is legal. This is clear from the opinions of the courts as reproduced earlier. When loopholes in tax legislation have been exploited for tax avoidance purposes, certainly the laws would not have been broken.

High rates of tax could make the cost of elaborate avoidance schemes worthwhile. This will support the view that the existence of widespread tax avoidance is evidence that the tax system requires radical reform.

The possible reaction of the Revenue Service to where loopholes in the tax legislation have been exploited is to take steps to block the loopholes. Thus, specific legislation would be passed to block particular loophole or loopholes. Such is referred to as specific anti-avoidance legislation. With one loophole blocked, the taxpayer would search out other loopholes and exploit same. There are therefore, bound to be several and unending specific anti-avoidance legislation to effective stop the taxpayer willing to carry out tax avoidance schemes. As the legislature cannot accurately foresee all schemes which the determined taxpayer could device, consideration would be given to the promulgation of general anti-avoid ancelegislation.

24.3.1 Anti-avoidance Legislation

The two possible forms of anti-avoidance legislation are:

(a) Specific legislation to block known tax avoidance devices; and

(b) General anti-avoidance legislation which vests the Revenue with power to disregard all transactions entered into that could be proved to have been entered into, solely for tax avoidance purposes.

The following are some advantages and disadvantages of each of these:

(a) **Specific Anti-Avoidance**

(i) **Advantages**

- Its provisions make the law imposing tax on a particular transaction clear and certain in its application.
- Ineffective or inadequate legislation can be readily amended.

(ii) **Disadvantages**

- May make an already complex legislation more complicated and less comprehensible to taxpayers, detracting from the simplicity canon of taxation.
- The taxpayer would seek further loopholes and again exploit such for further tax avoidance which may create an unending need for further legislation.

(b) **General Anti-Avoidance**

(i) **Advantages**

- The number of anti-avoidance legislations is reduced, consequently minimising the complexity of the tax laws.
- Provisions exist in the tax legislation to discourage all future tax avoidance, that is, schemes that are considered to have violated the spirit of the tax laws.

(ii) **Disadvantages**

- Provisions are general, vague and could lack precision
- Too much reliance is placed on discretion of tax officials for its application. The tax officials could exceed the intention of the legislature in certain respects or fail to carry it out in full in some others.

In the United Kingdom, specific anti-avoidance legislation exists that gives their tax authorities the power to set aside certain tax avoidance schemes. Tax avoidance schemes that could be cancelled are:

(i) Where there exists a pre-ordained scheme, involving a number of steps, aimed at tax avoidance; or

(ii) Where steps are inserted for tax purpose without a commercial or business purpose, regardless of whether they have a business effect. The taxpayer will have a defence if he can show that:

(iii) The transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of business, and

(iv) None of the transactions had as their main object or one of their main objects the obtaining of a tax advantage.

Introduction of general anti-avoidance rules have been considered in the UK. The conclusion was that general anti-avoidance rules might be the way forward. Such have to be drafted so that there is no infringement on the rights of taxpayers and that normal commercial transactions are not jeopardised in the process.

It was reported that general anti-avoidance rules have been tried in Australia, New Zealand and Canada with little success. This could further strengthen the view that specific legislation may be more desirable.

In Nigeria, besides few specific anti-avoidance provisions scattered throughout the tax Acts, CITA Section 22 contains the general anti- avoidance provisions regarding Companies taxation. Similar provisions are contained in PITA Section 17 and PPTA Section 15, relating to Personal taxation and Petroleum Profits taxation, respectively.

CITA Section 22

Where the Revenue Service is of the opinion that any disposition is not in fact given effect to or that any transaction which reduces or would reduce the amount of any tax payable is artificial or fictitious, it may disregard any such disposition or direct that such adjustments be made in respect of tax liability as it considers appropriate so as to counteract the reduction of tax liability which would otherwise be affected by the transaction and any company concerned shall be assessed accordingly.

Transactions between persons, one of whom either has control over the other or, in the case of individuals, who are related to each other or between persons both of whom are controlled by some other person, shall be deemed to be artificial or fictitious, if in the opinion of the Revenue Service, those transactions have not been made on terms which might fairly have been expected to have been made by persons engaged in the same or similar activities dealing with one another at arm's length. A company, in respect of which any direction is made under this Section, shall have a right of appeal in like manner as though such direction were an assessment. The whole idea of these provisions is that where any disposition is not in fact given effect to, the consequence of which is that a tax liability which should normally arise from such disposition did not arise, the Revenue Service would want to step in. This provision is intended to cover cases where the purported transaction, if recognised as valid, would enable the taxpayer to avoid payment of income tax on that which is truly his taxable income.

The transaction(s) would be considered as artificial, that is, not genuine or fictitious.

When these situations are established, the tax authority may disregard such disposition. In the alternative, the authority may direct that such adjustments shall be made in respect of the income of an individual, or an executor, or a trustee, as the authority considers appropriate so as to counteract the reduction of liability to tax effected, or reduction which would otherwise be effected by the transaction.

Summaries of two UK cases are quoted below for further illustration.

Ramsey (WT) Ltd. v. IRC (1981) STC 174

The taxpayer had implemented an elaborate tax avoidance scheme with the sole purpose of reducing a liability to CGT by creating allowable losses. The House of Lords held that although every transaction in the scheme was genuine, they were self-cancelling and the court should look at the effect of the transaction, which was to avoid tax. The scheme as a whole produced neither gain nor loss and so should be disregarded for tax purposes.

Furniss v. Dawson (1984) STC 153

The Ramsey principle was extended in this case beyond the self- cancelling transactions. A scheme would also be rejected where steps in the transaction are inserted that have no commercial purpose other than to avoid tax.

24.4 Tax avoidance and tax evasion compared

Tax evasion and tax avoidance and tax evasion can be compared as follows:

Tax avoidance		Tax evasion	
(i)	Legal	(i)	Illegal
(ii)	Achievable through exploiting loopholes in the tax laws.	(ii)	Achievable through deliberate action of fraud and deceit.
(iii)	Results in taxpayer paying minimum tax possible without breaking the law.	(iii)	Results in taxpayer not paying correct tax or paying minimum tax through the breaking of tax laws.
(iv)	Supported by the courts in decided cases.	(iv)	No support by the courts.
(v)	No criminal liability.	(v)	Tax evader could be charged to court for criminal offences with the consequent fines, penalties and, at times, imprisonment.
(vi)	When stretched to the extreme, the scheme could bedisregarded.	(vi)	At any level, Revenue Service will frown at tax evasion.
(vii)	No Revenue Service investigation. Prior years assessments will not be reopened.	(vii)	Revenue Service investigation will be instituted. Revenue Service has the power to open prior assessments beyond the six-year statute of limitation.

24.5 Other tax planning issues

24.5.1 Thin Capitalisation

A company is said to be thinly capitalised when its capital is made up of a much greater proportion of debt than equity, i.e. its gearing, or leverage, is too high. This is perceived to create problems for two classes of people:

(a) Creditors bear the solvency risk of the company, which has to repay the bulk of its capital with interest ;and

(b) Tax authorities, who are concerned about abuse by excessive interest deductions.

Credit risk

If the shareholders have introduced only a nominal amount of paid-up share capital, then the company has lower financial reserves with which to meet its obligations. If all or most of the company's capital comes from debt, which (unlike equity) needs to be serviced, and ultimately repaid, it means that the providers of capital are ultimately competing with the company's trade creditors for the same capital resources.

At the risk of generalising, most traditionally common law countries do not tend to employ thin capitalisation rules generally in relation to raising and maintenance of capital. However, a number of civil law jurisdictions do.

However, in almost all jurisdictions there are certain types of regulated entity which require a certain amount, or a certain proportion, of paid-up share capital to be licensed to trade. The most common examples of this are banks and insurance companies. This is because if such companies were to fail and go into liquidation, the economic effect of such failures can lead to a domino effect, which can have catastrophic consequences for other businesses and, ultimately, regional economies.

Tax issues

Even where countries' corporate laws permit companies to be thinly capitalised, tax authorities in those countries will often limit the amount that a company can claim as a tax deduction on interest, particularly when it receives loans at non-commercial rates (e.g. from connected parties). However, some countries simply disallow interest deductions above a certain level from all sources when the company is considered to be too highly geared under applicable tax regulations.

Some tax authorities limit the applicability of thin capitalisation rules to corporate groups with foreign entities to avoid "tax leakage" to other jurisdictions. The United States "earnings stripping" rules areexamples. Hong Kong protects tax revenue by prohibiting payers from claiming tax deductions for interest paid to foreign entities, thus eliminating the possibility of using thin capitalisation to shift income to a lower-tax jurisdiction.

24.5.1.1 Provisions of Finance Act, 2019 on thin capitalization

Prior to the commencement of Finance Act, 2019, there are no thin capitalization rules in Nigeria. However, in practice, FIRS sometimes seeks to disallow interest deductions considered excessive, which in most cases usually done arbitrarily.

The Finance Act, 2019 now introduces a specific benchmark of thirty percent (30%) of earnings before interest, taxes, depreciation and amortization (EBITDA) in a year as the limit for interest deduction on loans by a foreign 'connected person'.
Where there is excess interest, such is considered as a disallowable deduction in that year.

Any unclaimed interest as a result of the restriction can be claimed within 5 years, after which it is lost. The Act exempts Nigerian subsidiaries of foreign companies engaged in banking and insurance from this rule.

24.5.2 Tax havens

Introduction

A tax haven is a state, country or territory where certain taxes are levied at a low rate or not at all. Individuals or corporate entities can find it attractive to establish shell subsidiaries or move themselves to areas with reduced or nil taxation levels relative to typical international taxation. This creates a situation of tax competition among governments. Different jurisdictions tend to be havens for different types of tax, and for different categories of people or companies. States that are sovereign or self-governing under international law have theoretically unlimited powers to enact tax laws affecting their territories, unless limited by previous international treaties.

Definitions

The Organisation for Economic Co-operation and Development (OECD) identifies three key factors in deciding that a jurisdiction is a tax haven:

(a) Nil or only nominal taxes. Tax havens impose nil or only nominal taxes (generally or in special circumstances) and offer themselves, or are perceived to offer themselves, as a place to be used by non- residents to escape high taxes in their countries of residence.

(b) Protection of personal financial information. Tax havens typically have laws or administrative practices under which businesses and individuals can benefit from strict rules and other protections against scrutiny by foreign tax authorities. This prevents the transmittance of information about taxpayers who are benefiting from the low tax jurisdiction.

(c) Lack of transparency. A lack of transparency in the operation of the legislative, legal or administrative provisions is another factor used to identify tax havens. The OECD is concerned that laws should be applied openly and consistently, and that information needed by foreign tax authorities to determine a taxpayer's situation is available. Lack of transparency in one country can make it difficult, if not impossible, for other tax authorities to apply their laws effectively. 'Secret rulings', negotiated tax rates, or other practices that fail to apply the law openly and consistently are examples of a lack of transparency. Limited regulatory supervision or a government's lack of legal access to financial records are contributing factors.

Classification

Corporations, in order to achieve effective tax avoidance, use multiple types of tax havens. Three types of tax haven form a Dutch Sandwich:

(a) Primary tax havens: the location where financial capital winds up. Subsidiary shell companies there have obtained rights to collect profits from corporate intellectual property (IP) by transfers from their parent.

(b) Semi-tax havens: locations that produce goods for sale primarily outside of their territorial boundaries and have flexible regulations to encourage job growth, such as free trade zones, territorial-only taxation, and similar inducements.

Conduit tax havens: locations where income from sales, primarily made outside their boundaries, is collected, and then distributed. Semi-tax havens are reimbursed for actual product costs, perhaps with a commodity mark-up. The remaining profits are transferred to the primary tax haven, because it holds rights to profits due to the corporate IP. By matching outflow to income they do not retain capital and their role, while crucial, remains invisible.

Large multinational corporations may have dozens of such tax haven entities interacting with each other. Each haven can claim that it does not satisfy definitions that attempt to place all tax havens into a single class. Even increased transparency does not change the effectiveness of corporate tax avoidance.

Examples

Research has suggested that roughly 15% of the countries in the world are tax havens, that these countries tend to be small and affluent, and that better governed and regulated countries are more likely to become tax havens, and are more likely to be successful if they become tax havens.

- Switzerland
- Luxembourg—primarily a conduit tax haven

Other sovereign countries that have such low tax rates and lax regulation that they can be considered semi-tax havens are:

- Ireland
- Netherlands—primarily a conduit tax haven.

Non-sovereign jurisdictions commonly labelled as tax havens include:

- Jersey;
- Isle of Man;
- British Overseas Territory;
- Bermuda;
- British Virgin Islands;
- Cayman Islands;
- Delaware, United States; and
- Puerto Rico (United States).
-

Methodology

At the risk of gross oversimplification, it can be said that the advantages of tax havens are viewed in the following four principal contexts:

(a) **Personal residency**

Since the early 20th century, wealthy individuals from high- tax jurisdictions have sought to relocate themselves to low-tax jurisdictions. In most countries in the world, residence is the primary basis of taxation. Almost no tax haven assesses any kind of capital gains tax, or inheritance tax. Individuals who are unable to return to a higher-tax country in which they used to reside for more than a few days a year are sometimes referred to as tax exiles.

(b) **Corporate residency**

Corporate persons, in contrast to natural persons, can own subsidiary corporations in many countries. That allows them to take advantage of the variety of laws, regulations, and conventions in multiple countries, without overtly engaging in any questionable activities. Only in extreme cases will they move their formal corporate headquarters.

(c) **Asset holding**

Asset holding involves utilising an offshore trust or offshore company, or a trust owning a company. The company or trust will be formed in one tax haven, and will usually be administered and resident in another. The function is to hold assets, which may consist of a portfolio of investments under management, trading companies or groups, physical assets such as real estate or valuable chattels. The essence of such arrangements is that by changing the ownership of the assets into an entity which is not tax resident in the high-tax jurisdiction, they cease to be taxable in that jurisdiction.

Regulation measures

To avoid tax competition, many high tax jurisdictions have enacted legislation to counter the tax sheltering potential of tax havens.

Generally, such legislation tends to operate in one of five ways:

(i) Attributing the income and gains of the company or trust in the tax haven to a taxpayer in the high-tax jurisdiction on an arising basis. Controlled Foreign Corporation legislation is an example of this.

(ii) Transfer pricing rules, standardisation of which has been greatly helped by the promulgation of OECD guidelines.

(iii) Restrictions on deductibility, or imposition of a withholding tax when payments are made to off shore recipients.

(iv) Taxation of receipts from the entity in the tax haven, sometimes enhanced by notional interest to reflect the element of deferred payment. The EU withholding tax is probably the best example of this.

(v) Exit charges, or taxing of unrealised capital gains when an individual, trust or company emigrates.

However, many jurisdictions employ blunter rules. For example, in France securities regulations are such that it is not possible to have a public bond issue through a company incorporated in a tax haven.

Also becoming increasingly popular is “forced disclosure” of tax mitigation schemes. Broadly, these involve the revenue authorities compelling tax advisors to reveal details of the scheme, so that the loopholes can be closed during the following tax year, usually by one of the five methods indicated above. Although not specifically aimed at tax havens, given that so many tax mitigation schemes involve the use of offshore structures, the effect is much the same.

Anti-avoidance came to prominence in 2010/2011 as nongovernmental organisations and politicians in leading economies looked for ways of reducing tax avoidance, which plays a role in forcing unpopular cuts to social and military programmes. The International Financial Centres Forum (IFC Forum) has asked for a balanced debate on the issue of tax avoidance and an understanding of the role that the tax neutrality of small international financial centres plays in the global economy.

Criticism

Tax havens have been criticised because they often result in the accumulation of idle cash which is expensive and inefficient for companies to repatriate. The tax shelter benefits result in a tax incidence disadvantaging the poor. Many tax havens are thought to have connections with fraud, money laundering and terrorism. While investigations of illegal tax haven abuse have been ongoing, there have been few convictions. Lobbying pertaining to tax havens and associated transfer pricing has also been criticised.

Some politicians have begun to stand up against the use of tax havens by large companies. Reform proposals, centring on the Big Four accountancy firms have been advanced. Some governments appear to be using computer spyware to scrutinise some corporations' finances.

24.5.3 Executives on foreign assignment

Income tax is levied on individuals who perform employment duties in Nigeria and those resident abroad, but who are employees of the Nigerian Government. An individual who is an employee of a non-resident entity is not liable to tax in Nigeria. If he/she spends less than 183 days (six months) in Nigeria in any 12 month period (one year) period, and if his/her remuneration is subject to tax in the country of residence. Where foreign-nationals are on assignment in Nigeria and will last for less than 183 days, taxes may not be applicable. However, the nature of the visa obtained may put the individual in a taxable positions.

Most countries of the world depend on their residency rule for tax, therefore Nigerian executives on short term assignments are not likely to be subjected to foreign tax laws, except for taxes like VAT and withholding tax.

24.5.4 Foreign direct investment

(a) Foreign Direct Investments: are investments in the form of controlling ownership in a business in one country by an entity based in another country.

It could be buying a company in another country or expanding the operations of an existing business in that other country.

(b) There have been however some incentives that have been provided by the Federal Government to invest in Nigeria.

(c) In December 1989, Nigerian Enterprises Promotion Act permitted 100% foreign ownership in any new venture, except those in banking, oil, insurance and mining.

(d) In 1992, the Nigeria Export Processing Zone Act was passed establishing Nigerian Export Processing Zone Authority (NEPZA). Free Trade Zone(FTZ)

(e) Transferability of funds

Nigerian Enterprises Promotion Act provided that a foreign investor in an enterprise shall be guaranteed unconditional transferability of funds through an authorised dealer in freely convertible currency of dividend of profit.

24.5.5 Non-tax factors

Once an investor has determined the business structure of his/her investments, the investor engages in identifying a jurisdiction with the infrastructure that will optimally attain his/her objectives. Infrastructure represents tax and non-tax incentive of the particular jurisdiction.

The tax regime that applies in a specific location is generally an important consideration of a holding company and usually plays a role in the decision of where company should be established. However non- tax factors cannot be undermined as they are key to the success of the investment that is undertaken. Factors that affect the choice of location, in other words, locational determinants, will differ from one business to another, depending on the objectives of the investment.

The more important non-tax factors include:

(a) Economic and political ability;

(b) Adequate physical, business, accounting and legal infrastructure;

(c) The absence (or limited presence) of bureau critic obstacles;

(d) Adequate communication channels;

(e) Ability to negotiate profit freely;

(f) Effective banking system; and

(g) The availability of an adequate dispute resolution mechanism.

The social, economic and political stability, and risks within different countries are major considerations in the decision-making, especially where the need for raising of finance is important. A factor that supplements the social, economic and political stability is the functionality of the country's legal system and rule of law. Thus, not only should the legal system be suitable for transacting business, but it should also be possible for legal subjects to enforce their legal rights.

Alternative dispute resolution as a legal process is normally an expedient and cheap alternative to the often lengthy legal processes. Where available, it too should be reliable. The country's government should also respect the rule of law and ideally have an enshrined constitution that protects the rights of the country's subjects. As Olivier and Honiball observe:… a combination of operational business activities with an intermediary holding company in a single legal structure could expose an operational company's assets and investments to commercial risks. Stable laws and ease of compliance could assist in offsetting such risks. The commercial language of the host country is also important. It is important that the language used is the same as the language of the investor (or at least a common language such as English or French). The importance of this factor is illustrated by the loss of popularity of the Danish holding company structure due to the requirement that compliance and reporting documentation had to be in Danish. Linked to the prevailing commercial language, are reliable communication channels such as telecommunication, fax and email, without which the performance of various roles would be impaired.

Business deals with control and management (including investment management) and the discharging of such services requires a few highly skilled people in the areas of law, financing and financing structures, economics, accounting and auditing. Most holding companies do not necessarily require large numbers of employees to be stationed in the host country.

24.5.6 Treaty shopping

Treaty shopping is a situation where a person, who is resident in one country (say the "home" country) and who earns income or capital gains from another country (say the "source" country), is able to benefit from a tax treaty between the source country and yet another country (say the "third" country). This situation often arises where a person is resident in the home country but the home country does not have a tax treaty with the source country.

Treaty shopping is an analysis of tax treaty provision by non-treaty party to structure an international transaction or operation so as to gain or take advantage of a particular treaty benefit. This practice consists in a resident of a state that is not a party to the double taxation treaty establishing an entity within a state that is party to the treaty in order to take advantage of its provision.

Consider a situation that there is double taxation treaty between country A and country B. Instead of a company resident in country C (which does not have a tax treaty with country A) investing directly in country A, it establishes a legal entity in country B through which it invests in country A in order to take advantage of country A/country B tax treaty to minimize its tax liability. Meanwhile, since there is no tax treaty between country C and the treaty countries (i.e. countries A and B), resident of country A and B will not receive equal tax treatment with respect to income derived from country C. Therefore, the principle of reciprocity is breached.

The problem of treaty shopping could be tackled through anti-treaty shopping provisions despite the fact that it is one of the most complex international tax rules. Some countries have also tackle the problem of treaty shopping by including in their tax treaties specific provision referred to as "limitation on benefit" or "LOB". These provisions limit the benefit under the treaties in certain circumstances. Therefore companies which are not bona fide residents of the treaty countries or which are set up for treaty shopping purpose may be denied the treaty benefits.

24.6 Advise on tax planning activities and strategies

Tax planning is the analysis and arrangement of a person's financial situation in order to maximize tax reliefs and minimize tax liabilities in a legal and efficient manner. In other words, tax planning refers to the "arrangement of a person's business or private affairs in order to minimize tax liability." Tax rules can be complicated, but taking some time to know and use them for your benefit can change how much you end up paying as tax.

There are always tax planning opportunities for companies and corporations regardless of their size or the jurisdictions they work on.

At the local level, corporate tax planning is carried out through a review of the company's income generation activities, expenses, benefits and other deductions, profit distribution, tax rates, and any other variable that may affect the final result, against the applicable law to find optimization opportunities.

In addition to local planning strategies, multinational enterprises (MNEs) can make use of international tax planning to take advantage of the differences in the rates from one jurisdiction to another, and the different tax benefits that may be offered between jurisdictions.

Nevertheless, is important to note that most countries are putting into effect regulations to prevent tax base erosion or profit shifting from one jurisdiction to other, emphasizing instead stricter regulations for transactions that involve lower taxation jurisdictions.

With a sound corporate tax planning process, companies can understand their requirements to comply with local legislation in the countries they operate.

Further to that, having knowledge of the various incentives and benefits available to them with comprehensive corporate tax planning will also enable the company to improve its profitability. With full compliance and awareness of available benefits, companies can minimize their tax burden and optimize available profits.

Tax planning is a right that taxpayers must exercise to reduce tax liability and improve profitability while fully complying with the standing legislation to avoid penalties and further risks. Therefore, taxpayers (both corporate and individuals) should make sure they engage an experienced and trusted tax planning strategist/consultants to receive sound advice and guidance, and make informed decisions on how to protect their themselves or company.

24.7 Chapter review

This chapter deals with tax planning, tax avoidance as tax schemes that taxpayers could utilise to achieve tax savings. Such tax saving schemes are only allowed, if obtained through legitimate exploitation of loopholes in tax laws. Tax evasion is subject to criminal prosecution and is subject to fines and/or imprisonment.

Some advanced tax mitigating issues were also discussed in this chapter.

Readers must have learnt the Thin Capitalisation rule introduced by the Finance Act, 2019.

24.8 Worked examples

24.8.1 Open-ended questions

(1) A taxpayer has been running his business under the name Malami Enterprises for several years. A limited liability company (Outsourcing Enterprises Limited) in the same trade was desirous of expanding its own market share. It therefore decided to make an attractive offer to the proprietor of Malami Enterprises. The proprietor is keen to accept the offer because of its attractiveness.

The sale is scheduled to take place at a mutually agreed date. The following details relating to Malami Enterprises are made available.

	₦
Adjusted profit for year ended 30 September 2001	80,000
Adjusted profit for year ended 30 September 2002	240,000
Adjusted profit for year ended 30 September 2003	360,000

The estimated profits for the year to 30 September 2004 and, that for the period to 30 January 2005, have been given as follows:

Year ended 30 September 2004	430,000
3 Months to 31 December2004	60,000
1 Month to 31 January2005	10,000

Required:
Advise the proprietor of Malami Enterprises on whether to dispose the business on 31 December 2004 or on 31 January 2005.

Support your answer with relevant computations.

(2) Recently, the Federal Government through the Finance Minister announced increases in the capital base of all categories of insurance companies. Opinion is, however, divided on the appropriateness or otherwise of this policy directive.

You have been appointed as a consultant by Ultimate Risk Limited, a Nigerian insurance company, to guide it through the entire process of raising the necessary additional capital through the Nigerian Stock Exchange.

Required:
Advise the management of Ultimate Risk Limited on the tax implications of the issues listed below:

(a) The cost of increasing the authorised share capital with the Corporate Affairs Commission, Abuja.

(b) The cost of obtaining approval from regulatory authorities like, the Nigerian Stock Exchange, Securities & Exchange Commission and National Insurance Commission (NAICOM).

(c) Acquisition of another insurance company. Concern yourself only with the tax implications from the side of the acquired company.

(3) With respect to tax planning, you are required to comment on each of the following:

(a) Bonus issue and dividend.

(b) Employer using staff remuneration.

(c) An investment of N3,200,000 in fixed deposit at a rate of 20% p.a. as against the same amount in a treasury bill at a rate of 18½% p.a.

(d) Life Assurance Policy.

(e) A company involved in manufacturing and exportation of agricultural plants.

(f) Roll over relief.

(g) Use of leased assets.

24.8.2 Suggested solutions to open-ended questions

1. Our reference (O/R) Your reference (Y/R)

19 May 2006

The Proprietor Malami
Enterprises Jibowu
Lagos.

Dear Sir,

Re : Advice on appropriate date of cessation

The above subject refers.

We wish to advise that on cessation of business, the tax authority has the right to assess the business either on actual year basis or on preceding year basis for the penultimate year. In practice, the tax authority will choose the higher of the two. For the final year, the assessable profit is the profit from 1st of January to the actual date ofcessation.

From the above, it can be seen that when profit is accruing at a reducing rate towards the date of cessation, it is more tax efficient to delay cessation as long as possible.

From the computations attached, the profit was reducing towards the date of cessation.

We, therefore, advise that the cessation be delayed till 31 January 2005.

Thank you and best regards. Yours
faithfully,
PAL Associates Limited

Fash Oni

Managing Consultant

Workings

Computations assuming 31 December 2004 as date of Cessation 2003 the higher of:

			₦
(i)	1/1/2003 -31/12/2003		
	(9/12 x ₦360,000 + 3/12 x₦430,000)=		377,500
(ii)	1/10/2001 -30/9/2002	=	240,000
	20041/1/2004 - 31/12/2004		
	(9/12 x ₦430,000 + ₦60,000)	=	382,500

Computations assuming 31 January 2005 as date of cessation

			₦
2003 1/10/2001 - 30/9/2002		=	240,000
2004 the higher of :			
(i)	1/1/2004 -31/12/2004		
	(9/12 x ₦430,000 + ₦60,000) or	=	382,500
(ii)	1/10/2002 -30/9/2003	=	360,000
2005 1/1/2005 - 31/12/2005			10,000

Summary of Assessable Profits

Tax year	**31/12/2004**	**31/1/2005**
	₦	₦
2003	377,500	240,000
2004	382,500	382,500
2005	NIL	10,000
Total	760,000	632,500

2. Our reference (O/R) Your reference (Y/R)

Date

The Board of Directors
Ultimate Risk Limited
Lagos.

Gentlemen,

Re : The Tax Implications of Meeting the New Capital Base for Insurance Companies

We wish to thank you for our recent appointment as the Consultant in respect of the above subject.

We wish to advise that:

(a) There is need to increase the authorised share capital from its present level to that stipulated by the recent policy directive. The relevant fees to be paid to the Corporate Affairs Commission are of a capital nature. This, therefore, serves as a guide in treating the amount as a disallowable expense for tax purposes. This is the position of the tax law.

(b) The cost of obtaining approval from the relevant authorities like Securities Exchange Commission (SEC), Nigerian Stock Exchange (NSE) and National Insurance Commission (NAICOM) will be considered as capital in nature. They will thus be treated as disallowable for tax purposes.

(c) In the case of an acquisition of another company, it is to be expected that the acquired company will cease to exist. This is the first tax implication for the acquired company.

The issues before acquisition of the company are as follows:

(i) Find out the tax status of the company to be acquired. Have all returns been filed? Have all the taxes been paid?

(ii) Check outstanding tax queries and determine the tax implications of any of them.

(iii) Confirm that tax audit has been carried out on the acquired company.

(iv) Obtain copy of the Company's Tax Clearance Certificate.

(v) Ascertain all outstanding issues on VAT and resolve same.

(vi) Ensure that Capital Gains Tax on any asset disposal are paid to the relevant tax authority.

(vii) Check Withholding Tax files for outstanding issues and resolve same.

(viii) Confirm payment of adequate Stamp Duties to be sure there will not be any outstanding payments due to misstatement of Stamp Duties paid during previous increases.

(ix) Cessation rules will not apply to the acquired company as it is deemed to be continuing in business.

(x) No initial allowance will be granted on the assets.

(xi) The assets will be deemed to have been transferred to the acquiring company at tax written down values and therefore to be written off over the unexpired life of the assets.

We hope this report will be carefully considered by the Board in due course. Should you require further clarifications, please do not hesitate to contact us.

Thank you.

Yours faithfully,

for: A-Z Consultant

Peter Okolo
for: Managing Director

NOTE:
This is a question on the process, cost and tax implications of increase in (i) Capital base by corporate insurance organisations and (ii) Acquisitions within the industry.

3. Tax planning can be described as a conscious effort on the part of a potential taxpayer, to organise his or her financial transactions (income and expenditure) in such a way as to legitimately minimise his or her tax liability at every point in time.

(a) **Bonus issue and dividend**
An investor in a company shall prefer scrip or bonus issue to dividend payment because the latter will attract 10% Withholding tax deduction on the dividend receivable. Gains made on disposal of stocks and shares currently (since 1998) do not suffer capital gains tax.

(b) **Employer using staff remuneration for planning**
This occurs when an employer in a bid to minimise the tax liability of the employees reduces the basic salaries and any other monetised benefits in favour of benefits in kind.

It should however be noted that, such benefits in kind like employers assets put to the employees use, will attract 5% of the acquisition cost, if known, or 5% of the market value of the assets at the time of acquisition. Also a company may decide to pay a lump sum to an employee, and choose to regard such amount as compensation for loss of office which is exempt from personal income tax.

(c) The investment of ₦3,200,000 in a fixed deposit account and treasury bill

	Fixed Deposit ₦	Treasury Bill ₦
Principal	3,200,000	3,200,000
Interest rate	X 0.2	X 0.185
Interest	640,000	592,000
Less: Withholding tax at 10%	64,000	NIL
Net income	576,000	592,000

Income savings resulting from taking the option of treasury bill is:
₦592,000-₦576,000 = ₦16,000

The investor has therefore saved ₦16,000 in income, by avoiding the withholding tax due under the fixed deposit option, having decided to invest in treasury bill.

(d) **Life assurance allowance**
An employee can minimise his tax liability by taking a life assurance policy, as actual premium payment in the preceding year is allowed for tax purposes, provided there is evidence that the policy is in his name, or in respect of a contract for a deferred annuity on his own life or the life of his spouse and evidence of payment of the premium in form of policy certificate. Also gains on disposal of interest under a life policy are exempted from capital gains tax.

(e) A company involved in manufacturing and exporting agricultural equipment instead of trading in such equipment, would enjoy the following tax incentives

(i) Capital allowances are not restricted for agro-allied business or agricultural equipment manufacturing companies. Losses incurred can be carried forward indefinitely.

(ii) If the company in question obtained a loan for the purpose of the export business, the interest income by the bank is exempted from tax depending on moratorium and repayment period. The interest expenses are treated as allowable charges against income. Dividends received from companies in this business are exempted from tax.

(iii) The Company can be granted pioneer status.

(iv) Companies with turnover of less than ₦1 million will be taxed at 20% in the first five years. Meanwhile, with the implementation of the Finance

Act, 2019, the companies will not be liable to income tax if it has turnover of less than ₦25 million and will be taxed at reduced rate of 20% if it has turnover of ₦25m and above but less than ₦100m. In addition, with implementation of the Finance Act, 2020, the company will not be liable to tertiary education tax if it has turnover of less than ₦25m

(f) **Roll – over relief**

A company may use the proceeds of sale of one asset to buy another asset of the same category and use for the same purpose as the one sold in order to escape paying capital gains tax that would have accrued on the disposal of the initial asset. Roll-over relief is also granted where compensation received for loss or destruction of an asset is re-invested in replacement within three years.

(g) **Use of leased assets**

This is used as a means of financing purchases of fixed assets and for tax planning. There are two types, namely finance and operating lease. The advantages accruing to a company from applying either type of financing include:

Under finance lease

(i) The lessee is entitled to claim capital allowances.

(ii) In a sale and lease back arrangement, the lessee also claims capital allowances.

(iii) Installment payments of principal plus interest made by the lessee company are allowable expenses.

Under operating lease

(i) The lessor will claim capital allowance.

(ii) Balancing charge /allowance are claimable in the events of disposal.

25

Tax audit and tax investigation

Contents

Tax audit and tax investigation

25.0 Purpose

After studying this chapter, readers should be able to:

(a) Distinguish between tax audit and tax investigation;

(b) Know the legal basis of the power of Tax Authorities to conduct tax audit and tax investigation;

(c) Know the objectives of tax audit;

(d) Know how to conduct a tax audit;

(e) Know the reasons for tax investigation;

(f) Know how to conduct a tax investigation; and

(g) Know typical documents/information required to conduct tax audit and tax investigation.

25.1 Introduction

Statutory audit

Statutory audit is an independent examination of an organisation's financial records by external auditors with a view to expressing an opinion on whether ornotan organization is providing a fair and accurate representation of its financial position. It is an examination usually conducted by an independent person, of a set of the accounting books, records, documents, etc, from which a set of financial statements has been prepared.

Objectives of statutory audit

The objectives of an audit are to express an opinion as to whether:

(a) Proper books have been kept;
(b) The financial statements are in agreement with the books;
(c) The requirements of applicable legislations, for example, CAMA, 1990 (as amended) have been complied with;
(d) Applicable accounting standards (both local and international) have been adhered to;
(e) The financial statements give a true and fair view of the state of the financial affairs of the enterprise as at its balance sheet date; and
(f) The financial statements give a true and fair view of the result of the operations of the

enterprise for the period under audit.

Specialised audits

Specialised audits are normally involved whenever special attention is needed on a special issue that is not part of the objectives of statutory audits. When a specialised audit is carried out, the auditor would cover in his report the particular objectives that are to be achieved as set out in the auditor's terms of reference.

25.2 Legal basis for the power of tax authorities to conduct tax audit and tax investigation

Tax audits are similar to specialised audits. They are additional to statutory audits and are carried out by tax officials from relevant tax authority (ies). The approach and scope of work would be slightly different from that to be carried out for audit under CAMA, 1990(as amended). The legal backing for conducting tax audit and tax investigation by the relevant tax authorities could be found in the following provisions of the tax laws:

Section 60(4) of the Companies Income Tax Act, Cap. C21, LFN 2004 as amended provides that:
"Nothing in this section or in any other provision of this Act shall be constructed as precluding the Service from verifying by tax audit or investigation into any matter relating to any return or entry in any book, document, accounts, including those stored in a computer, digital or magnetic, optical or electronic media as may, from time to time, be specified in any guideline by the Service"

Section 66(1) of the Companies Income Tax Act, Cap. C21, LFN 2004 provides that:
"If the Board discovers or is of the opinion at any time that any company liable to tax has not been assessed or has been assessed at a less amount than that which ought to have been charged, the Board may, within the year of assessment or within six years after the expiration thereof and as often as may be necessary, assess such company at such amount or additional amount, as ought to have been charged, and the provision of this Act as to notice of assessment, appeal and other proceedings shall apply to such assessment or additional assessment and to tax charged there under"

Provided that where any form of fraud, wilful default or neglect has been committed by or on behalf of any company in connection with any tax imposed under this Act, the Board may at any time and as often as may be necessary, assess such company at such amount or additional amount as may be necessary for the purpose of making good any loss of tax attributable to the fraud, wilful default or neglect.

Section 55 of Personal Income Tax Act, Cap. P8, LFN 2004

(1) If the relevant tax authority discovers or is of opinion at any time that a taxable person liable to income tax has not been assessed or has been assessed at a less amount than that which ought to have been charged, the relevant tax authority may, within the year of assessment or within six years after the expiration thereof and as often as may be necessary assess the taxable person assess the taxable person at such amount or additional amount as ought to have been charged, and the provisions of this Act as to notice of assessment, appeal and other proceedings shall apply to that assessment or additional assessment and to the tax there under.

(2) For the purpose of computing under subsection (1) of this section the amount or the additional amount which ought to have been charged, all relevant facts consistent with

paragraph (b) of the proviso to section 66 (2) of this Act shall be taken into account whether or not known when a previous assessment on the same taxable person for the same year was being made or could have been made:

Provided that where any form of fraud, wilful defraud or neglect has been committed by or on behalf of a taxable person in connection with any tax imposed under this Act, the relevant tax authority may at any time and as often as may be necessary assess that taxable person at such amount or additional amount as may be necessary for the purpose of making good any loss of tax attributable to the fraud, wilful default or neglect.

Section 3(1) of Petroleum Profits Tax Act, Cap. P13, LFN 2004: The due administration of this Act and the tax shall be under the care and management of the Board which may do all such acts as may be deemed necessary and expedient for the assessment and collection of the tax and shall account for all amounts so collected in a manner to be prescribed by the Minister.

Section 36 of Petroleum Profits Tax Act, Cap. P13 LFN 2004

(1) If the Board discovers or is of the opinion at any time that, with respect to any company liable to tax, has not been charged and assessed upon the company or has been charged and assessed upon the company at a less amount than that which ought to have been charged and assessed for any accounting period of the company, the Board may within six years after the expiration of that accounting period and as often as may be necessary, access such company with tax for that accounting period at such amount or additional amount as in the option of the Board ought to have been charged and assessed, and may make any consequential revision of the tax charged or to be charged for any subsequent accounting period of the company.

(2) Notwithstanding the other provisions of this section, where any form of fraud, wilful default or neglect has been committed by or on behalf of any company in connection with any tax imposed under this Act, the Board may, at any time and as often as may be necessary, assess the company on such amount as may be necessary for the purpose of recovering any loss of tax attributable to fraud, wilful default or neglect.

Section 39 of the Value Added Tax Act, CAP, V1, LFN 2004:

(1) An authorised officer may at any time enter without warrant any premises upon which he has reasonable grounds to believe that a person is carrying on business in order to ascertain whether this Act is being complied with (whether on the part of the occupier of the premises or any other person) and on entry he may carry out such inspections and make such requirements as may be specified by the Board.

(2) Where an authorised officer enters any premises in exercise of the power conferred on him by subsection (1) of this section he may take with him such persons as he considers necessary for carrying out his functions under this Act.

Section 24 of Stamp Duties Act, Cap. S8, LFN 2004:

(1) Every person having in his custody any rolls, books, records, papers, documents, or proceedings, the inspection whereof may tend to secure any duty, or to prove or lead to the discovery of any fraud or omission in relation to any duty, shall at all reasonable times permit any person thereto authorised by the commissioner to inspect the rolls, books, records, paper, documents and proceedings, and to take such notes and extracts as he deems necessary, without fee or reward and in case of refusal, shall for

every such refusal be guilty of an offence and be liable on Conviction to a fine of twenty Naira.

(2) Where such rolls, books, records, papers, documents or proceedings are in the custody of any bank, such inspection shall first be made by a commissioner unaccompanied by any other person unless the commissioner decides that it is necessary for him to have assistance in determining whether any fraud or omission in relation to any duty has taken place.

An integral part of the self-assessment scheme is the need to periodically verify the tax returns filed by taxpayers through a tax audit process. The tax audit exercise essentially is meant to enable the tax authority to further satisfy itself that audited financial statements and the related tax computations submitted by the taxpayer agree with the underlying records. This periodic check is carried out by the tax audit branch.

Objectives of tax audit

The objectives are to enable the tax auditors determine whether or not:

(a) Adequate accounting books and records exist for the purpose of determining the taxable profits or loss of the taxpayer and consequently, the tax payable;

(b) The tax computations submitted to the tax authority by the taxpayer agree with the underlying records; and

(c) All applicable tax legislations have been complied with.

Other objectives of tax audit are:

(i) Provision of an avenue to educate taxpayers on various provisions of the tax law;

(ii) Discourage tax evasion;

(iii) Detect and correct accounting and/or arithmetical errors in tax returns;

(iv) Provide feedback to the management on various provisions of the law and recommend possible changes;

(v) Identify cases involving tax fraud and recommend them for investigation;

(vi) Forestall taxable persons' failure to render tax returns;

(vii) Forestall taxable persons rendering incomplete or inaccurate returns; and

(viii) To encourage voluntary compliance which is one of the strong reasons in support of the self-assessment scheme. Tax audit is usually conducted by a group of experienced personnel of the Revenue Authority.

25.2.1 Differences between tax audit and tax investigation

The differences between tax audit and tax investigation could be summarized as follows:

i. Tax audit was introduced to empower the relevant tax authority to conduct tax audit. Tax audit is legally required periodically, to confirm the accuracy of the self-assessment of a taxpayer. Tax investigation is similar to any other form of investigation. It is not carried out on routine basis as that of a tax audit;
ii. In a tax investigation, the scope of work is wider than that of a tax audit. The details of checking and depth of the work will also likely be more than what is required for a tax audit exercise;
iii. Tax investigation would be carried out when a taxpayer is suspected to have committed fraud. Suspected cases of tax evasion could lead to investigation. Meanwhile, tax audit is routine in nature;
iv. Tax investigation is conducted by tax inspectors who have special training and competence in investigation techniques. They can request for assistance of police investigators and enforcers, if necessary. These are not required for tax audit; and
v. The principal aim of investigation is to expose all the circumstances of fraud or tax evasion and to obtain evidence for possible prosecution. Tax investigators have been given greater power than tax auditors. They can seal up a business premises to facilitate their work and obtain all the documents needed to substantiate the evidence of tax evasion and fraud.

25.3 Tax audit departments

These are departments within the Federal Inland Revenue Service (FIRS) and States Internal Revenue Service (SIRS) that are saddled with the responsibility of conducting tax audit of taxpayers. With the current reform exercise at FIRS, there is National Tax Audit Department situated at the headquarters while Regional Tax Audit Unit also exist at each of the regional offices across Nigeria.

25.4 Types of tax audit

The two types of tax audit are:

(a) Desk audit; and
(b) Field audit.

Desk audit

This is also called desk review or desk examination. It is conducted on the tax return submitted to a tax office. As soon as a tax return is received in the tax office, such would be subjected to examination by the tax official. This examination is carried out in the tax office. It is carried out on routine basis, indicating that most, if not all, returns submitted to the tax office are subject to this audit.

The focus of the desk audit or desk review would be to ensure completeness of the returns submitted. The officer carrying out a desk audit will also look for apparent errors or mistakes in the tax computations and/or in the accompanying documents and records. The outcome of desk audit or desk review is usually a desk audit report or query letter issued to taxpayer stating the findings from the review and requests the taxpayer to respond to the audit findings within a specified period of time. On receipt of desk audit or desk review findings report from a tax office, the taxpayer should respond to the tax office within the timeline specified or request for extension of time to respond, if it is not feasible to respond within the time specified by the tax office. Receipt of formal response from the taxpayer is usually followed with reconciliation meetings between the tax authority and taxpayer. Where the taxpayer is unable to provide the necessary documentary evidence to support the returns being audited through desk audit or desk review, it may lead to issuance of additional assessment by the tax authority.

In addition, in some cases, whenever additional information or documentary evidence required to satisfy the officer carrying out the desk audit or desk review are not satisfactorily provided, a desk audit may lead to the conduct of a field audit.

Field audit

A field audit is more elaborate and comprehensive than a desk audit. It is usually carried out outside the tax office, in the taxpayer's business premises. The need to carry it out in the taxpayer's premises is to enable the tax auditors carry out the examination of applicable documents and also obtain appropriate information directly from the officials of the business.

25.5 Stages involved in field tax audit

The stages involved in field tax audit are as follows:

(a) Selection of taxpayer to be audited;

(b) Preliminary review of tax payer's file;

(c) Notification of taxpayer;

(d) Pre-audit meeting followed immediately by field audit;

(e) Post-audit meeting;

(f) Interim audit report;

(g) Post audit review by Regional/Headquarters Audit;

(h) Reconciliation meetings; and

(i) Final audit report.

25.5.1 Selection of taxpayer to be audited

The guidelines and criteria for selection of files for audit are to be determined by the tax audit department/unit. The selection of cases for audit is a management function.

The criteria which would vary from one type of audit to the other include, but are not limited to the following:

(a) Self-assessment taxpayers – at least two years since the last audit of the taxpayer;

(b) Taxpayers with refund claims – especially arising from excess withholding tax credits and, or other named reasons;

(c) Taxpayers with nil returns or continuous loss situation;

(d) Taxpayers with very low adequacy ratios;

(e) Based on routine industry checks or sartorial audit (project audit);

(f) Based on lead information received from Intelligence or other FIRS departments or external sources;

(g) Transfer pricing arrangements;

(h) Tax planning schemes;

(i) Claims under Double Taxation Agreement (DTA);

(j) Secondary files – relationship with another taxpayer by way of holding, subsidiary, associated or related companies, could be criteria for selecting companies for audit;

(k) Industrial group's compliance evaluation and profitability comparison;

(l) Verification of poor or extraordinary performance;

(m) Referrals resulting from desk audit or desk examinations;

(n) Information resulting from examination, audit and investigation of other taxpayers;

(o) Random sampling;

(p) Firms making unusual requests or taking extraordinary decisions such as centralising an erstwhile decentralized operation;
(q) Information from intelligence unit of the tax authority; and
(r) Directive from higher government authority.

25.5.2 Preliminary review of taxpayer's file

This is aimed at preparing both the audit department and the audit team that will be involved in the audit exercise for the audit task ahead.

It involves obtaining basic information about the taxpayer, analytical review of taxpayer's performances using ratio analysis and highlighting risk areas for the audit exercise.

This review will also lead to the determination of the appropriate tax audit strategies to be adopted, which include, recommendation on the audit approach, number of days/weeks required, level of experience and technical skills required, number and location of officers to be assembled for the field audit exercise. This procedure will be reviewed and approved by the head of audit department or unit, as appropriate.

Preliminary activities

Before audit personnel set out, certain preliminary activities must take place. These are:

(a) gathering of the relevant files and grouping them into the number of audit teams to be established;
(b) audit teams to acquaint themselves with background information about their cases;
(c) prepare audit checklists to be used in respect of each company to ensure that all necessary areas of audit activities are covered;
(d) design interview format (if necessary) for each company, depending on the problems, so as to ensure that all grounds are covered; and
(e) assign specific duties to audit team members.

Audit checklist

The complexities of some businesses and/or the need for comprehensiveness make the preparation of audit checklist necessary at the planning stage of a tax audit. The checklist is used during the audit exercise to ensure that a thorough job is done. It also ensures that the exercise is undertaken systematically and not in a haphazard manner. Thus, it makes the audit work to be faster, orderly and properly completed. The activity items listed in the checklist are ticked off as performed one after the other as the work progresses, until the audit is completed.

Background information

The following are basic information to be extracted from the taxpayer's file:

(a) Name of the company;

(b) Registered address;

(c) Business address;

(d) Date of incorporation;

(e) Date of commencement of business;

(f) Tax file number;

(g) Nature of business;

(h) External auditors/tax consultants and their addresses;

(i) Bankers/addresses;

(j) Solicitors and secretaries;

(k) Share capital (authorized and issued);

(l) Shareholding structure;

(m) Names of directors/number of shares held;

(n) Associated companies/addresses;

(o) Litigation details, if any;

(p) Period covered during the last audit or investigation exercise; and

(q) Accounting yearend.

Analytical review of tax returns

The officer-in-charge will use the following records to determine the taxpayer's performances and areas of tax audit focus:

(a) Last audit or investigation report (if any).

(b) Financial statements:

  (i) Chairman/directors/auditors' reports;

  (ii) Statement of financial position and statement of comprehensive income;

  (iii) Cash flow statements ;and

  (iv) Notes to the accounts.

(c) Tax returns.

From the above, a spreadsheet of balance sheet, profit and loss accounts and notes to the accounts of the years to be covered is prepared.

Ratios

The relevant ratios, out of the following, would be computed and interpreted:

(a) **Liquidity/solvency**

These are ratios designed to measure taxpayer's ability to meet his obligations.

(i) Current (or working capital)ratio

(ii) Acid test (or quick)ratio

(iii) Working capital turnover

(iv) Assets turnover

(b) **Efficiency (activity)**

These are ratios that measure effectiveness of a taxpayer in using his assets.

(i) Account receivable to turnover ratio

(ii) Age of accounts receivable

(iii) Inventory turnover

(iv) Working capital turnover

(v) Asset turnover

(c) **Equity position and coverage**

These are ratios that measure the balance between the resources provided by the creditors and owners of the company.

(i) Debt equity ratio

(ii) Debt to total assets ratio

(iii) Book value per ordinary share

(d) **Profitability**

These are ratios that measure the ability of the taxpayer to generate an excess over turnover.

(i) Profit margins on sales

(ii) Return on investment

¨ Return on total assets

¨ Return on owners equity

(iii) Ratio of tax already assessed to net profits

(iv) Ratio of cost of sales to turnover

The tax auditor should bear the following tax evasion tendencies in mind:

(a) Understatement of income;

(b) Overstatement of expenses;

(c) Undervaluation of stocks;

(d) Creation and maintenance of secret reserves;

(e) Post-dating sales (what happens to the related costs when income is post-dated);and

(f) Omission of income.

Proper interpretation of these ratios will lead to determination of the risk areas for tax audit focus.

25.5.3 Notification of taxpayer

On completion and approval of the preliminary review by the Head of the audit unit, the taxpayer or his tax consultants will be notified of the field audit, which will then be carried out in the company's premises.

The notification letter will state the following:

(a) Period (years) that the audit exercise will cover.
(b) List of records/documents to be made available for the audit. The company should be notified that this list is not exhaustive.
(c) Date and time of commencement of audit exercise.
(d) Names of the tax officials that will carry out the audit.

Members of the audit team are expected to carry their identity cards. The identity cards should only be shown on request by the taxpayers but should neither be taken away from the auditors nor allowed to be photocopied.

25.5.4 Pre-audit meeting

(a) The field audit exercise must commence with a preliminary meeting with the management of the company, usually represented by the Managing Director and/or Financial Director or their representatives.

The company's tax consultants, where necessary, are also expected to be in attendance at this meeting.

(b) The pre-audit meeting is aimed at:

(i) Informing the taxpayer of the purpose of the audit.

(ii) Confirming background information of the taxpayer earlier obtained in the assessment file.

(iii) Getting other relevant information that are not available in the file.

(iv) Familiarisation with the company's accounting and operational systems which include, but not limited to, the following:

- Whether the company operates manual or computerize accounting system;
- Whether the accounting system is on cash or accrual basis;
- The invoicing system in place for sales and purchases; and
- Whether all cash received are banked intact before expending there from.

(v) Giving the taxpayers the opportunity to express their views on the audit.

(vi) Seeking the cooperation of the taxpayer in terms of providing books and records, and explanation where necessary.

(c) The team leader is expected to chair the meeting while a member of the audit team is expected to take minutes of the meeting.

(d) Part of the functions of the team leader is to approve the draft of the minutes and ensure that the final copy is produced and signed on the field by the officer that prepared it, the team leader and the company's representative, as well as the tax consultant, where necessary. A copy of the signed minutes must be given to the representatives of parties concerned.

25.5.5 Actual field audit

After the pre-audit meeting, the Revenue officer will commence the field audit proper starting with the list of records/documents to be made available for the audit earlier sent to the taxpayers when tax audit notification was sent. Documents/information provided by the taxpayers are thoroughly reviewed at this stage. Additional documents/information will be requested by tax officers and explanations are sought from taxpayers on some items.

25.5.6 Post-audit meeting

A post-audit meeting should be held immediately after the end of the field audit, between the tax auditors and the taxpayers and their representatives at the taxpayer's premises. The purpose of this meeting is to obtain any further outstanding information/document that maybe available only from the taxpayer's management and to answer outstanding questions that arose during the field audit work. Minutes of the meeting should be documented in writing, signed by both parties and a copy given to both parties. This marks the end of the field audit and departure from the taxpayer's premises.

25.5.7 Interim audit reports

Preliminary reports: Sometimes, the scheduled officer of a case, would come across material issues, in the course of the preliminary review of the assessment file, that should be brought to the notice of the management. In such an instance, a preliminary report would be prepared and sent to the head of audit department detailing such issues.

Interim reports: After the field audit, but before the conclusion of the audit exercise, progress reports could be called for by management. The team leader should collate the individual reports of all the team members and write the Interim Audit Report. The report should highlight details of all the findings that may result in additional tax assessment as well as areas of possible dispute with the taxpayer and suggestions on how to resolve them.

The report should be addressed to and reach the Head of regional tax audit unit or the Director of Tax Audit Department at Headquarters as appropriate within one week of the post audit meeting.

25.5.8 Post-audit review by regional/headquarters auditors

The Regional/Headquarters Audit Department will review the interim audit report as soon as it is received, by giving clear directives on all reported matters, after due consideration of the technical issues involved based on the prevailing tax laws, as well as the generally accepted accounting principles. This will form the basis for the reconciliation meetings.

25.5.9 Reconciliation meetings

This is a meeting between the tax auditors (with representatives of Regional/Headquarters Audit present as appropriate) on the one hand and the taxpayers (and their representatives and tax consultants) on the other hand. The purpose of the meeting is to resolve all outstanding issues arising from the field tax audit exercise with a view to determining the additional tax due and resolving all disputes in accordance with the tax laws of Nigeria.

After the reconciliation meeting, additional assessment may be issued as appropriate with notices, while outstanding matters treated to a logical conclusion.

However, in case of any formal objection by the taxpayer, the reasons for the objection will be considered and notice of amended assessments or notice of refusal to amend the assessment will be issued as appropriate.

Objections by the tax payer to the additional assessment should be made within reasonable time, otherwise the additional assessment become final and conclusive. Where notice of refusal to amend is issued, the tax auditor should ensure that due process is strictly adhered to in documentation, record keeping and correspondences as these may affect the success of FIRS' defence against any appeal filed by the taxpayer before the Tax Appeal Tribunal.

It should be noted that all further appeals lie with the High Courts, Court of Appeal and Supreme Court. All that transpired at the reconciliation meeting should be documented in form of minutes, which will be signed and distributed to all parties.

25.5.10 Final audit report

The audit report is very important and should be rendered immediately an audit is completed. It contains all important items about the company and the audit work done. Audit reports tend to expose a system's weaknesses and shoddy audit job is also easily revealed. The report will state the findings and details of tax liabilities, if any. An audit report should always be completed with the auditors' recommendations. Such recommendations may include the need for extended audit, special investigation and even prosecution.

Based on the minutes and outcome of the reconciliation meetings, the final audit report will be written by the audit team leader. The report which should be addressed to the Regional/Headquarters Audit Department, will state in detail, the additional assessments agreed at the reconciliation meeting as well as those disputed.

The additional assessments agreed should be separated from those disputed. Both should be analysed in tabular form under various taxes (CIT, WHT, CGT, VAT, PAYE, etc) for each year of assessment concerned. The report should indicate details of how each additional assessment was arrived at. The Regional/Headquarters Audit Department will consider the report within a reasonable time of its receipt and issue clear directives for issuance of Notices of additional assessments, Amended assessments and Notice of refusal to amend assessment, as appropriate. The report will also form the basis of FIRS defence in case of an appeal to the Tax Appeal Tribunal, in which case, a copy of the report will be sent to the Legal Adviser for follow-up.

25.6 Types of audit exercise

25.6.1 Routine sector audit

This audit covers companies operating within a specific industry, for example, banking, construction, oil servicing, shipping. The objective is primarily to ascertain and assess the overall compliance level in the particular industry.

25.6.2 Routine zonal audit

This type of audit is conducted on all organisations or companies in particular zones, irrespective of industry of the taxpayer.

25.6.3 Special purpose audit

Apart from routine audits, sometimes management would direct the tax audit department or unit to carry out audit to achieve a specified purpose. Such instances include:

i. Verification of taxpayers' claims for tax refunds;

ii. Dispute between taxpayers and the tax office on specific issues;

iii. Suspected cases of tax evasion;

iv. Value Added Tax audit; and

v. Management's directives.

25.6.4 Technical procedures in tax audit

Technical procedures refer to the process of carrying out tax audit. It involves planning, organising and executing all activities required to effectively carry out the audit. The process could be grouped as follows:

(a) **Allocation of audit cases:** All referred cases must be allocated to individual tax official who would be the schedule officer for each case. The criteria for allocating cases are mainly the level of competence of an officer, considering the urgency attached to the audit, the technicality involved, size of the company and other relevant factors.

(b) **Pre-audit visit activities:** The schedule officers' first task would be to obtain the company's assessment file (and sometimes, the collection file) from the office where the taxpayer file is domiciled for the purpose of extracting relevant financial data. After the extractions, a comprehensive file review would be done and a report written. The report will show the background information of the company, the tax history, relevant performance ratios, and comments on tax queries raised by the Area Office, areas of potential audit risks and recommendation as to outcome of the audit.

(c) **Circularisation letters:** These may be sent to identified third parties for independent confirmation of certain information.

(d) **The field audit:** An audit team comprising officers and a team leader would visit the company to carry out the field examination of the company's records. The duration of the field work depends on the volume and complexity of the company's operations.

(e) **Reconciliation process:** After the field audit, the summary of the audit findings would be sent to the company and its tax consultants for their reaction and a date is then fixed for reconciliation. The reconciliation involving the review of additional, written representations, interviews and meetings would then begin until when all contentious issues have been resolved. Thereafter, a final letter of intent detailing the Revenue's position on the unresolved issues and computation of any additional tax would be sent to the taxpayer.

(f) **Assessment:** The relevant notices of additional/revised assessment are raised after the letter of intent has been sent. This will be done by the assessment department. Also, the collection department would be advised to pursue collection of any tax that may become due as a result of the field audit exercise.

(g) **Objections:** Objections to the additional assessment could be raised either immediately after the letter of intent has been received by the taxpayer or after the notices of additional assessment have been raised. In either case, a review of the working papers or whole file would be initiated with a view to ascertaining the validity of the company's objection. Sometimes a revisit would be made to the company to verify any new documents available. Having confirmed that the position adopted by the Tax Audit is right, notices of refusal to amend the assessments would be raised after obtaining the headquarters' authority to do so. The case could then be referred to the Legal Section for litigation.

(h) **The final report:** Once all objections, if any, have been disposed of, a final report of the tax audit exercise would be made to the management. The major elements of the report would include: the background information of the company, the pre- and post-audit tax adequacy ratio, the audit work performed, major audit findings, tax yield, recommendations and conclusions.

25.7 Audit programme

This is a schedule of audit work expected to be performed on each item of the accounts such as income/turnover, expenditure, assets and liabilities.

Benefits of the audit programme

The audit programme would be useful in the following areas:

(a) It will provide details of the work, which the team leader requires individual members of the team to perform.

(b) It will provide information as to how much of the audit work has been completed as at a particular date, and how much is outstanding.

(c) Provides a record of audit responsibility by providing a record of the audit staff members responsible for each part of the completed work.

(d) Facilitates audit supervision and control, giving senior members of the audit team information and knowledge regarding the progress of the work done to date.

(e) Ensures continuity in the audit work, should there be a change in the personnel constituting the audit team, with new members being able to see at a glance the outstanding work to date, thus providing a basis for planning and staffing the audit team.

(f) Provides an avenue for the team leader to allocate his available staff in the most productive and efficient manner possible.

(g) It is a time management tool.

The thrust of a tax audit will be that of verification of the figures and other information submitted by the taxpayer for tax purposes.

The primary purpose of tax audit has been expanded to monitor and maintain the confidence in the integrity of the newly introduced self- assessment system. It helps to improve voluntary compliance by detecting and bringing into account those who do not pay the correct amount of tax. Tax audit is a routine exercise and the outcome usually leads to reassessment or referral for special investigation, if tax evasion is suspected.

25.7.1 Tax investigations

Investigations, as distinct from audits, are called for, when there are problems in, an organisation either affecting the whole or particular segments of the organisation. Such could be required when a large fraud is suspected or when evidence of mismanagement abounds and an interested party requires that the effect on the enterprise be quantified for management decision-making purposes.

In an investigation, the scope of work is wider than that of an audit. The details of checking and depth of the work will also likely be more than that required for an audit exercise.

Tax investigation is similar to any other form of investigation. It is not carried out on routine basis as that of tax audit. For example, a statutory audit of the accounts of a company must be carried out every year, whereas investigation may not be carried out in the same company for several years.

Tax investigation would be carried out when a taxpayer is suspected to have committed tax fraud. Suspected cases of tax evasion could lead to investigation. These could be due to failure to file tax returns, filing of incomplete or inaccurate returns, failure to register for tax purposes,etc.

Special Investigation results from suspicion or actual knowledge of the existence of tax evasion or tax fraud. It is conducted by tax officials who have special training and competence in investigation techniques. They can request for assistance of police investigators and enforcers, if necessary.

The principal aim of investigation is to expose all the circumstances of the tax fraud or tax evasion and to obtain evidence for possible prosecution. Tax investigators have been given greater power than tax auditors. They have powers to obtain all the documents needed to substantiate the evidence of tax evasion and tax fraud.

In summary, tax investigation could be triggered or caused by any of the followings:

a. Failure to register for tax purposes;
b. Refusal to file tax returns despite persistent request and visitation by the tax office in-charge;
c. Refusal to allow access to books and records;

d. Abusive tax scheme or aggressive tax avoidance scheme;
e. Suspicion of tax fraud;
f. Denial of access of tax audit exercise;
g. Regulatory authority sanction of the taxpayer i.e. CBN, NDIC, SEC, NCC etc.;
h. Non- remittance of taxes collected on behalf of the tax authority i.e. Value Added Tax and
i. Withholding Tax;
j. Negative media tax report on the company;
k. Whistle blowers on tax evasion / fraud by the company; and
l. Referral from tax audit or law enforcement agencies.

25.8 Stages of tax investigation

Actual investigation of tax cases involves the following stages:

(a) **Surveillance or pre-investigation activities**

This involves checking and cross-checking, obtaining more information on the alleged tax fraud. It involves discrete analysis of data, reports and complaints. These have to be done speedily or the offence could become compounded.

(b) **Notification of taxpayer**

On completion of surveillance or pre-investigation activities, the taxpayer to be investigated will be formally notified of the investigation exercise which will be carried out in the taxpayer's premises. The notification letter will state the period (years) that the investigation will cover, list of records/documents to be made available for the investigation, date and time of commencement and names of the tax officials that will carry out the exercise.

(c) **Pre-investigation meeting**

The investigation exercise must commence with a preliminary meeting with the management of the organisation to be investigated usually represented by the Managing Director and/or Financial Director or their representatives. The organisation's Tax Consultants, where necessary are also expected to be in attendance at this meeting.

The meeting aimed at:

- Informing the taxpayer of the purpose of the investigation;
- Confirming background information of the taxpayer earlier obtained in the surveillance or pre-investigation activities assessment file;
- Familiarisation with the company's accounting and operational systems;
- Giving the taxpayers opportunity to express their views on the investigation; and
- Seeking the cooperation of the taxpayer in terms of providing books and records and explanation where necessary.

The investigation team leader is expected to chair the meeting while a member of the investigation team is expected to take minutes of the meeting. A signed copy of the minutes of meeting must be given to the representatives of parties concerned.

(d) **Evidential audit or investigation**

Once pre-investigation meeting is concluded, the investigators move into the business premises of the taxpayer to conduct in- depth tax investigation, take charge of any evidence discovered, secure a warrant of arrest and have the suspect arrested if necessary. At this stage, any individual may be invited for investigation. Also, thorough searches of individuals, offices and apartments may be conducted to obtain relevant evidence that might be useful in prosecuting the case.

(e) **Case preparation**

This involves the collation of evidence, the interrogation of suspects, and careful examination and analysis of seized documents to assess their relevance to the case and potency in the law courts. At this stage, the case can still be dropped if the evidence is weak.

(f) **Arraignment**

This is the stage where the case goes to court for criminal prosecution. All the evidence collected and witnesses secured are made available to the prosecutor who is thoroughly briefed on the case.

(g) **Termination of investigation**

Investigation in a case of criminal tax fraud or tax evasion can be terminated at any stage, if the following conditions obtain:

i. Insufficient evidence;

ii. Criminality is not involved; may be what happened was tax avoidance and not tax evasion or fraud;

iii. There can be termination by law where continuation can no longer be sustained under the provisions of the law. An example is where such a case becomes statute-barred; and

iv. If the suspect dies or becomes medically or legally insane.

25.9 Investigation/intelligence department

The Investigation/Intelligence Department of the Federal Inland Revenue Service (FIRS) is in charge of all investigations and intelligence activities of FIRS.

The roles and responsibilities of the Head of the Department are as follows:

(a) Articulate and direct policies and programmes aimed at achieving the objectives of the department;

(b) Define key operating / guiding principles;

(c) Design strategies for deterring violations of tax laws, hence ensuring tax compliance;

(d) Set up procedures for case referrals from tax offices;

(e) Set up proactive processes and define parameters for identifying potential cases of violations;

(f) Address emerging areas of fraud, for example, e-commerce fraudulent financial reporting;

(g) Collate and maintain reliable statistics of investigations/intelligence work;

(h) Coordinate the activities of all the units in the department;

(i) Develop and implement appropriate training programmes for field officers on how to conduct investigation/intelligence work, preparing a case for court, computer searches for evidence gathering and data recovery, etc.;

(j) Partner with other experienced tax jurisdictions in the area of information sharing, latest developments in taxation, including emerging areas of tax fraud, computer searches and data recovery;

(k) Liaise with the various regulatory agencies on issues of tax violations;

(l) Provide law enforcement agencies with information sufficient to prosecute violators;

(m) Provide management with an update of cases prosecuted;

(n) Develop and maintain a system of records to track and report on cases, their progress and results;

(o) Recommend amendments to tax laws in order to plug all areas of tax leakages; and

(p) Budget and plan for financial, material and human resource requirements of the department.

25.10 Civil investigations unit

The activities of this unit revolve around the following:

(a) Investigate tax avoidance schemes; Examples are:

i. Artificial transactions – Section 18 of CITA states that is any transaction carried out primarily to obtain tax benefits (reduction or avoidance or deferral of tax or increase in refund of tax, etc).

ii. Creating an offshore company for purposes of reducing tax payable. For example, instead of having the Nigerian company buy direct from a foreign supplier, a related offshore company is set up in a tax haven country to do this and will in turn sell the product at a higher amount to the Nigerian company, thereby diverting profits offshore. Another example would be when a profitable division is moved offshore. The key is to determine if in fact it is operating offshore.

Treaty shopping. This involves shopping for the best tax rates offered by treaty countries and then carry out transaction in such a manner to take advantage of those tax rates.

iii. Back to back loans (e.g. to avoid Withholding Tax (WHT) or enjoy lower treaty rate).

iv. Alleged purchase of foreign assets at inflated amounts, which results in excess capital allowances claim.

v. The use of tax havens and its detrimental impact on the tax system could be significant, both in terms of revenue and compliance.

vi. Income splitting arrangements.

(b) Investigate cases for tax refunds.

(c) Review cases for mergers and acquisitions.

(d) Issue warrants for search and seizure under Section 45A.

(e) Refer cases to criminal investigations unit where there are indications of deliberate intention to evade tax or commit fraud, etc.

(f) Identify areas of amendments to tax laws in order to plug all areas of tax leakages.

25.11 Criminal investigation unit

(a) The criminal investigation unit is responsible to:

Investigate, penalise and recommend prosecution in cases of tax evasion. With tax evasion, you have fraud with “mensrea”. The amounts are clearly taxable (suppression of income, fictitious expenses) and does not require an amendment to the tax law. Evasion transactions are done knowing that it is unlawful to do so. Normally, criminal charges are laid which could result in fines and / or a jail term in addition to the tax and penalties. Examples are:

i. Arrangements premeditated to reduce tax payable;
ii. Understatement or non-disclosure of income;
iii. Overstatement of expenses;
iv. Creation of fictitious assets and expenses;
v. Disproportionate share of expenses and income between offshore and on shore entities;

vi. The use of artificial transactions;

vii. Complex management structure and associated entities that would result in tax evasion;

viii. Non-filing of tax returns or filing of incorrect returns ;and

ix. Denial of Federal Inland Revenue Service access to records.

(b) Investigate and liaise with relevant agencies for prosecution in cases of:

i. Fraudulent diversion of Federal Inland Revenue Service taxes such as Withholding tax, Value Added Tax, etc.;

ii. Fraudulent payment of income tax and other taxes through use of falsified withholding tax receipts;

iii. Abuses by companies and government agencies in Value Added Tax / Withholding Tax deduction and remittance; and

iv. Fraudulent procurement of Tax Clearance Certificate, revenue receipts, Withholding Tax Credit notes.

(c) Carry out search and seizure where such would result in obtaining relevant document for an investigation.

(d) Analyse and evaluate evidence obtained to establish criminal violation, follow up with assessment, penalties and prepare case for prosecution.

(e) Identify the areas of amendments to tax laws in order to plug all tax leakages.

(f) Assist in preparing evidence for prosecution of violators.

(g) Liaise with the National Drug Law Enforcement Agency (NDLEA), Economic and Financial Crimes Commission (EFCC), Nigeria Deposit Insurance Corporation (NDIC) and Central Bank of Nigeria (CBN) to investigate violation of tax laws in cases of white-collar crimes such as money laundering.

25.12 Intelligence unit

The main function of this unit will be to gather and analyse information and thus maintain a database of information for civil/criminal investigation and the Federal Inland Revenue Service in general.

Specifically, the unit will:

(a) Liaise with tax offices to obtain information on returns filed including late returns, etc for the taxpayer database;

(b) Liaise, on a regular basis, with banks and the Corporate Affairs Commission to obtain information on new accounts (Section 44), new companies, that is,non-filers;

(c) Liaise with Ministries/government parastatals on contracts for current and prior years, for cross-checking returns filed by companies;

(d) Gather and review information in newspapers, magazines, journals, radio and television for signs of potential civil or criminal violations;

(e) Use intelligence techniques (for example, surveillance techniques and computer database searches) to gather information on a company’s businesses, financial activities,etc.;

(f) Carry out special enforcement programmes on suspected targets;

(g) General intelligence collection;

(h) Refer cases to the civil or criminal investigation unit after carrying out relevant analysis;

(i) Obtain information from third parties; and

(j) Obtain and review published financial statements of offshore companies.

25.13 Assessment of investigation/intelligence department

The perceived strengths and weaknesses of the Investigation/ Intelligence Department are:

Strengths

i. Top management support;

ii. Quality staffing with officers of high integrity and professional competence, mostly chartered accountants, economists and lawyers;

iii. Enforcement powers in the tax laws such as power to issue warrants after due consultation with the management in the case of resistance; and

iv. FIRS legal unit's continued assistance in the prosecution of tax offenders and advising on legal issues.

Weaknesses

i. Internal and external interference.

ii. Obstruction of investigation through abuse of the judicial process.

iii. Conflicts between Tax Audit Section in tax offices and Civil Investigation Unit.

iv. Delays through lack of cooperation from taxpayers in the provision of necessary documents and records.

v. Inadequate funding due to budgetary constraints.

vi. Inadequate experience in criminal investigation.

vii. Reliance on external bodies such as the Nigerian Police, Economic and Financial Crimes Commission, etc.

viii. Inadequate Infrastructure - computers and equipment to perform necessary duties and unstable power supply.

25.14 List of required documents for Federal Inland Revenue Service tax audit and investigation exercise

(a) Audited accounts for the relevant years

(b) Management accounts

(c) Chart of accounts

(d) Year-end final trial balances

(e) General ledgers/ledger printouts

(f) Back up documents for entries in the General Ledger

(g) Audit adjustment journals

(h) Relevant schedules

(i) Sales invoice file

(j) Purchases invoice file

(k) Payment Vouchers for bank and petty cash payment

(l) Import documents

(m) Export documents (where applicable)

(n) Fixed Assets Register/Schedules

(o) Value Added Tax file(s)

(p) Evidences of Input VAT claimed

(q) Evidences of VAT deducted at source (if any)

(r) Evidence of Zero rated/Exempted VAT items

(s) Withholding tax file(s)

(t) Capital gain tax records

(u) Schedule of Bankers and the bank statements for each of the period of audit coverage.

(v) Minutes of Board's meetings

(w) Stock count records

(x) Schedule of contracts executed, contract agreements/offer letters and Valuation Certificate for company engaged in construction.

(y) Rent agreements

(z) Any other documents required for the audit/investigation.

25.15 List of required documents for States Internal Revenue Service's tax audit and investigation exercise

(a) Audited financial statements (AFS) /management accounts for the year(s) under review

(b) General ledger/trial balance

(c) Staff list with designation

(d) Payroll for local staff and expatriate staff

(e) Schedule of company vehicles and designation

(f) Analysis of staff cost in the audited financial statements

(g) Evidence of registration and monthly remittance of pension

(h) Evidence of registration and monthly remittance of National Housing Fund(NHF) and Nigeria Social Insurance Trust Fund (NSITF)

(i) Schedule of local and expatriate PAYE tax paid

(j) Employment contracts of both temporary & permanent expatriate staff

(k) Letter of expatriate quota for the company

(l) Copies of monthly returns on expatriates to Immigration Service

(m) Copies of expatriate deletion form

(n) Payment advice to banks for local and expatriate staff

(o) Schedule of the company's operating and administrative expenses

(p) List of suppliers/contractors, including their addresses
(q) Payment vouchers for the period under review

(r) Rent schedule and rent agreement
(s) Schedule of withholding tax paid

(t) Names and address of directors

(u) Schedule of payments made to directors

(v) Copies of Tax Clearance Certificate of the directors

(w) List of the company offices, including head office

(x) Receipt for the business premises registration/renewal

(y) Receipt for the development levy paid

(z) Any other documents required for the audit.

25.18 Assessment procedures after tax audit or tax investigation

If after tax audit or tax investigation, the relevant tax authority or the Board discovers that any taxpayer liable to tax has been assessed at a less amount than which ought to have been charged, the Board may, within a year of assessment or within six years after assess such taxpayer at such additional amount as ought to have been charged. The assessment raised by the Board at this juncture is referred to as additional assessment or back duty assessment.

Features of back duty /additional assessment are:

(i) It arise on a tax audit exercise where the relevant tax authority has reviewed the underlying records of a taxpayer to confirm that the records agree with the returns that were earlier on filed.

(ii) Any difference observed between the original returns and the underlying records form the basis of an additional assessment. This may be due to fraud, willful default or neglect by the taxpayer, which were discovered from the review of the documents submitted.

(iii) Such additional assessments may become the subject of the objection and appeal procedures.

(iv) Back-duty work is limited to 6 years before the year of the audit.

Objection and appeal procedure

Valid objection: Where best of judgement assessment or any assessment is raised and served on a taxpayer, but the taxpayer is aggrieved, the tax laws makes provision for the taxpayer to object to such assessment. For such objection to be considered valid, the following conditions must be met:

(a) The objection must be in writing

(b) The objection must be made within thirty (30) days of the service of the notice of c Assessment

(c) The objection must state the grounds for objection and include the figure for the revised Assessment

Where the tax authority is satisfied with the grounds of objection, or agrees with the taxpayer on alternative figures, the assessment will be discharged and a revised/amended assessment would be raised. However, where the tax authority did not agree with the taxpayer on the ground of objection, the tax authority will issue a notice of refusal to amend (NORA).

If after objecting to the assessment and the Board issue a notice of refusal to amend the assessment, an appeal will be lodged with the Tax Appeal Tribunal (TAT). The appeal will be in the form of notice to the Board, and to the Secretary of the Tax Appeal Tribunal and must be made within thirty (30) days after the date of service of notice of the refusal of the Board to amend the assessment.

The notice of appeal against the assessment will contain the following:-

i. The official number of the assessment and the year for which it was made;
ii. The amount of tax charged by the assessment;
iii. The amount of total profits upon which the tax was charged;
iv. The date the notice of refusal was served;
v. The grounds of appeal as contained in the notice of objection; and
vi. An address for service of any notice.

Should the Tax Appeal Tribunal refused the appeal on points of law, an appeal will be made against such decision to the Federal High Court.

Further appeal by either of the party against the decision of the Federal High Court will be made to the Court of Appeal and Supreme Court.

Final and conclusive assessments

An assessment is deemed to be final and conclusive if:

- The objection or appeal is not made within the statutory time limit (30 days);
- When an objection has been made against an assessment by the company/individual and subsequently the company/individual agrees with the relevant tax authority as regards the amount to which it is liable to be assessed; and
- On appeal, the assessment is determined by the tax appeal tribunal, federal high court or the court of appeal.

25.19 Power of distrain for non-payment of tax

Where an assessment has become final and conclusive, and a demand note has been served on the company or upon the person in whose name the company is chargeable, then if payments of the tax is not made within the time limited by the demand note, the Board may, for the purpose of enforcing payment of the tax due seek the power of court to:

a) Distrain The tax payer by his goods or other chattels, bonds or other securities; and
b) Distrain upon any land, premises or places in respect of which the tax payer is the owner and, subject to certain proviso, recover the amount of tax due by sale of anything so distrained.

The proviso applicable includes the fact that:

i. The authority to distrain is a sufficient warrant and authority to levy by distress the amount of tax due;
ii. The authority may be exercised by any officer authorised in writing by the Board. He may carry out his function by breaking open any building or place if necessary in the day time for the purpose of levying such distress and he may call to his assistance any police officer. It shall be the duty of the police officer when so required to aid and assist in the execution of any warrant of distress and in levying the distress;
iii. The items distrained may be kept for a period of fourteen days at the cost of the tax payer after which they may be sold in the event that the tax due is not paid;
iv. The sales proceeds is applied in meeting the incidental cost of keeping and selling the items distrained and the payment of tax, penalty and interest owed. The balance shall be paid to the tax

payer upon a demand by him provided such a demand is made within one year of the date of sale; and

v. No immovable property may be sold without an order of a high court.

25.20 Power of search and seizure

Where the tax authority has a reasonable ground to suspect that an offence involving an form of total or partial non-disclosure of information or any irregularity or offence in connection with tax has been committed or can be found on the premises, registered office or any other office or place of management of the taxpayer or in his residence or the residence of its principal officers, agents, or representatives, the tax authority may authorize any of its officers to enter, if necessary by force, such locations at any time from the date of such authorization and conduct a search.

The authority to enter and search must be made in the prescribed form in the sixth schedule of Companies Income Tax Act (CITA) and eighth schedule of Personal Income Tax Act (PITA)

Upon entering the premises, the officer may seize and remove anything whatsoever found therein which he has reasonable cause to believe may be required for the purpose of arriving at a fair and correct tax chargeable on the taxpayer or as evidence for the purpose of proceedings in respect of such an offence.

An officer authorized to carry out any such search and seizure may execute any warrant by calling to his assistance any police officer and it shall be the duty of the police officer to aid and assist him.

25.21.1 Chapter review

This chapter defines tax audits and tax investigations and explains their objectives. It also describes the two types of tax audit and explains the process of carrying out a tax audit, especially under the current self- assessment regime.

There is explanation on preliminary matters to be addressed before an audit is commenced, what to do during an audit and what needs to be done in concluding an audit, both in the taxpayer's office and in the tax auditors' office.

These include the preparation of audit checklist, preliminary meeting between the taxpayer's representatives and the tax auditors, analytical review of tax returns, post-audit meetings and final audit report, as well as, raising of additional assessment, if any, to conclude a tax audit.

However, in the case of tax investigation, an intelligence unit of the tax authority is involved in sourcing for tax information as regards incomes from all sources received by, or paid to a named taxpayer.

The chapter also identifies the typical documents usually requested for by the Federal Inland Revenue Service and States Internal Revenue Services to conduct tax audit and tax investigation.

25.22 Worked Examples

25.22.1 Open-ended questions

1. DYO Nigeria Plc is a manufacturer of home appliances. The company has been operating as an indigenous business for the past fifteen years. The company has branches in the six geographical zones of Nigeria and it is still planning to expand its business beyond Nigerian shores.

   The operating efficiency of the company appears sufficiently sound and would be able to overcome any competitive activity. The company is quoted on the stock exchange; hence it is easily seen how positive its share trend has been.

   The company has efficient staffing policy, hence the staff members are professionals in their individual disciplines.

   In the last three years, the tax office has been having a running battle with the company on the tax returns under self-assessment system being forwarded to the tax authorities. In the last two years, the tax office insisted that the company be assessed on best of judgement. This decision did not go down well with the Managing Director of the company. Series of meetings were held between the company and the tax authority, but without any success.

   With the breakdown of communication between the two parties, the tax office wrote to the company that a team of tax investigator were on their way to the company and that they should be given free access to the company's tax related matters.

   The Managing Director now feels that he would not like to involve any party in the problem existing on tax matters and that he would like to know if tax auditors should be involved instead of investigators.

   Required:
   As a consultant to the company, explain the following:

   (a) (i) Tax Audit.
   (ii) Checklist in tax audit.
   (iii) Tax audit report.
   (iv) Compare tax investigators with tax auditors.

   (b) Discuss the stages involved in tax investigation.

   (c) What can lead to the termination of a tax investigation?

2. As a consequence of the cash flow problems experienced by most state governments in Nigeria, most of them have secured the services of tax consultants to carry out back duty and tax investigations. This has increased the returns into the coffers of the various state governments just as it has necessitated filing of notices of appeal and appearances before the Tax Appeal Tribunal.

Required:
Explain the following:

(a) Back duty and tax investigation.

(b) Investigatory power.

(c) Search and seizure.

(d) Appeals.

(e) Notices of appeal.

(f) Hearing of appeal.

(g) Appeal against the decision of Tax Appeal Tribunal.

(h) When an assessment is final and conclusive.

3. List the stages in a typical tax audit process.

4. "Tax audit is conducted for the purpose of ensuring that a taxpayer has conducted his affairs in accordance with the tax laws and practices".

Required:
Explain the following regarding the tax audit of the Revenue:

(a) Objectives of a tax audit.

(b) Selection of tax payers for audit.

5. As an experienced tax consultant, one of your clients based in Lagos has approached you that it noticed that the Federal Inland Revenue Service and Lagos State Internal Revenue are carrying out random tax audit of companies in Lagos and wants to be prepared for such exercise, should both tax authorities decide to conduct similar exercise on its organisation. Consequently, the company is seeking your help to present the list/schedule of possible documents that will be requested for the exercise by each tax authority.

Required:
(a) Prepare the schedule of requirements for Federal Inland Revenue Service tax audit

(b) Prepare the schedule of requirements for Lagos State Internal Revenue Service tax audit

25.22.2 Suggested solutions to open-ended questions

1(a)(i) **Tax audit**
Tax audit is the examination carried out by tax officials on the accounting books,

records, documents and tax returns filed by a company with a view to determining the level of compliance with the provisions of the tax laws.

(ii) **Tax audit checklist**
This is the comprehensive list of the documents and information required in carrying on the audit. It ensures that the exercise is carried out in a systematic manner.

(iii) **Tax audit report**
This is the report issued by the tax officials on the audit exercise carried out on a company. The report should state the period covered by the audit, the scope of work done, findings and the additional tax liability established.

(iv) **Tax investigators/tax auditors**
Tax investigation aims to unearth fraud no matter how long and to secure evidential materials for possible prosecution of tax evasion or tax fraud in the law court. Investigators have a greater authority than tax auditors because they can take all possible steps to facilitate their work and obtain all the documents needed to substantiate the existence of tax evasion or fraud. Tax auditors' major focus is on checking that the taxpayers has complied with the relevant provision of tax laws.

(b) **Stages of tax investigation**

(i) **Surveillance or pre-investigation activities**
This involves checking and cross-checking of information and documentation on the purported tax fraud or complaint. It involves discrete analysis of data, reports and complaints.

(ii) **Notification of taxpayer**
On completion of surveillance or pre-investigation activities, the taxpayer to be investigated will be formally notified of the investigation exercise which will be carried out in the taxpayer's premises. The notification letter will state the period (years) that the investigation will cover, list of records/documents to be made available for the investigation, date and time of commencement and names of the tax officials that will carry out the exercise.

(iii) **Pre-investigation meeting**
The investigation exercise must commence with a preliminary meeting with the management of the organisation to be investigated, usually represented by the Managing Director and/ or Financial Director or their representatives. The organisation's Tax Consultants, where necessary, are also expected to be in attendance at this meeting. A signed copy of the minutes of meeting must be given to the representatives of parties concerned.

(iv) **Evidential audit or investigation**
At this stage, investigators move into the business premises of the taxpayer, conduct in-depth tax audit, take charge of any available evidential materials, secure a warrant of arrest (if necessary) and lock up the suspect. At this stage, any individual can be invited for interrogation.

(v) **Case preparation**

This involves the collection of witnesses, the interrogation of taxpayer and a careful examination and analysis of documents obtained. At this stage, the case can be stopped, if the evidence is weak.

(iv) **Arraignment**

At this stage, it means that the case has gone to court for criminal prosecution. Therefore, the court processes will start until the case is concluded and judgement passed.

(c) **Termination of investigation**

An investigation of a criminal tax fraud or tax evasion can be terminated at any stage based on the following conditions:

(i) Insufficient evidence;

(ii) Criminality is not involved. This may be where tax avoidance is mistaken for tax evasion; or

(iii) If the suspect dies or becomes medically or legally insane.

2. (a) Back-duty assessment will arise on a tax audit exercise where the relevant tax authority has reviewed the underlying records of a taxpayer to confirm that the records agree with the returns that was earlier obtained on-field. Any difference observed between the original returns and the underlying records form the basis of an additional assessment. Such additional assessments may become the subject of the objection and appeal procedures. Meanwhile, such back-duty work is limited to six years before the year of the audit.

On the other hand, an investigation is a more rigorous exercise which has no limit for the examination. Here, it may be triggered by some criminal activities such as outright evasion of tax. It will usually involve the use of law enforcement agents and the offenders may be charged to court for criminal activities.

(b) **Investigatory power**

(i) The Service shall employ Special Purpose Tax Officer to assist any relevant law enforcement agency in the investigation of any offence under the tax laws:

(ii) The Service shall have the power to investigate or cause investigation to be concluded to ascertain any violation of any tax law whether or not such violation has been reported to the service;

(iii) In conducting any investigation under (b) above, the Service may cause investigation to be conducted into the properties of any taxable person, if it appears to the Service that the lifestyle of the person and extent of the properties are not justified by the source of income;

(iv) Where any investigation reveals the commission of any offence or an attempt to commit any offence, the Service shall undertake the prosecution of the offences.

(c) **Search and seizure**

Where the tax authority has a reasonable ground to suspect that an offence involving any form of total or partial non-disclosure of information or any irregularity or offence in connection with tax has been committed or can be found on the premises, registered office or any other office or place of management of the taxpayer or in his residence or the residence of its principal officers, agents, or representatives, the tax authority may authorise any of its officers to enter, if necessary by force, such locations at any time from the date of such authorisation and conduct a search.

The authority to enter and search must be made in the prescribed form in the sixth schedule of the Act.

Upon entering the premises, the officer may seize and remove anything whatsoever found there in which he has reasonable cause to believe may be required for the purpose of arriving at a fair and correct tax chargeable on the taxpayer or as evidence for the purpose of proceedings in respect of such an offence.

An officer authorised to carry out any such search and seizure may execute any warrant by calling to his assistance any police officer and it shall be the duty of the police officer to aid and assist him.

(d) **Appeals**
A taxpayer may appeal against the decision of either the tax authority or the court, where it is not satisfied. Such appeals must be lodged in writing and not later than 30 days after the receipt of the Notice of refusal to amend or the receipt of the judgement of the court.

(e) **Notices of appeal**
The Notices of appeal must be written, contain the grounds of appeal and must be lodged not later than 30 days after the receipt of the Notice of Refusal to Amend or the receipt of the judgement of the court.

The Notice of appeal must contain certain basic information such as the name of the taxpayer; the tax file number; the relevant year assessment; the amount of taxable profit; the amount of assessment; the date the notice of refusal to amend or the judgement of the court was received and the ground of appeal.

(f) **Hearing of appeal**
The hearing of the appeal before the Tax Appeal Tribunal is usually made in public. Sometimes, the hearing will involve the taxpayer and the tax authority being represented to make their case. Each party is allowed the use of its auditors, tax consultants and legal advisers. The decision of the Tax Appeal Tribunal is usually under the hands of the chairman.

(g) **Appeal against the decision of the Tax Appeal Tribunal** Once judgement has been delivered at Tax Appeal Tribunal, an appeal may be lodged to the High Court within 30 days of receipt of the judgement. The appeal must be written and must show the grounds upon which the appeal is being made.

(h) **When an assessment is final and conclusive**
An assessment becomes final and conclusive where no valid objection or appeal has been lodged within the time limit. It is also applicable where an assessment as made or agreed to, revised or determined on appeal has not been the subject of a further appeal within the time allowed.

3. Stages in tax audit process include:

(a) Selection of the taxpayer to be audited;

(b) Preliminary review of the tax payer's file;

(c) Notification of taxpayer;

(d) Pre-audit meeting;

(e) Fieldwork;

(f) Post-audit meeting;

(g) Interim audit report;

(h) Post-audit review by regional/headquarters' audit unit;

(i) Reconciliation meetings; and

(j) Final audit report.

4(a) The objectives of a tax audit are to enable the tax auditors determine whether or not:

(i) Adequate accounting books and records exist for the purpose of determining the taxable profits or loss of the taxpayer and consequently the tax payable;

(ii) The tax computations submitted to the tax authority by the taxpayer agree with the underlying records;

(iii) All applicable tax legislations have been complied with;

(iv) Provision of an avenue to educate taxpayers on various provisions of the tax law;

(v) Discourage tax evasion;

(vi) Detect and correct accounting and/or arithmetical errors in tax returns;

(vii) Provide feedback to the management on various provisions of the law and recommend possible changes;

(viii) Identify cases involving tax fraud and recommend them for investigation;

(ix) Forestall taxable persons' failure to render tax returns;

(x) Forestall taxable persons' rendering incomplete or in accurate returns; and

(xi) To encourage voluntary compliance which is one of the strong reasons in support of the self-assessment scheme.

Tax audit is usually conducted by a group of experienced staff of the Revenue.

(b) The guidelines and criteria for selection of files for audit are to be determined by the Tax Audit Department. The selection of cases for audit is a management function.

The criteria which would vary from one type of audit to the other include, but are not limited to the following:

(i) Self-assessment taxpayers – at least two years since the last audit of the taxpayer.

(ii) Taxpayers with refund claims – especially arising from excess withholding tax credits and, or other named reasons.

(iii) Taxpayers with nil returns or continuous loss situation.

(iv) Taxpayers with very low adequacy ratios.

(v) Based on routine industry checks or sectorial audit (project audit).

(vi) Based on lead information received from Intelligence or other FIRS departments or external sources.

(vii) Transfer pricing arrangements.

(viii) Tax planning schemes.

(ix) Claims under double taxation agreement (DTA)

(x) Secondary files – relationship with another taxpayer by way of holding, subsidiary, associated or related companies, could be criteria for selecting companies for audit.

(xi) Industrial group's compliance evaluation and profitability comparison.

(xii) Verification of poor or extraordinary performance.

(xiii) Referrals resulting from desk examinations.

(xiv) Information resulting from examination, audit and investigation of other taxpayers.
(xv) Random sampling.

(xvi) Firms making unusual requests or taking extraordinary decisions such as centralising an erstwhile decentralised operation.

(xvii) Information from intelligence unit of the tax authority. (xviii)Directive

from higher government authority.

5(a) List of required documents for Federal Inland Revenue Service tax audit

i. Audited accounts for the relevant years

ii. Management accounts

iii. Chart of accounts

iv. Year-end final trial balances

v. General ledgers/ledger printouts

vi. Back up documents for entries in the General Ledger

vii. Audit adjustment journals

viii. Relevant schedules

ix. Sales invoice file

x. Purchases invoice file

xi. Payment vouchers for bank and petty cash payment

xii. Import documents

xiii. Export documents (where applicable)

xiv. Fixed assets register/schedules

xv. Value Added Tax file(s)

xvi. Evidences of Input VAT claimed

xvii. Evidences of VAT deducted at source (if any)

xviii. Evidence of zero rated/exempted VAT items

xix. Withholding tax file(s)

xx. Capital gain tax records

xxi. Schedule of bankers and the bank statements for each of the period of audit coverage.

xxii. Minutes of Board's meetings

xxiii. xxiii. Stocks count records

xxiv. Schedule of contracts executed, contract agreements/offer letters and valuation certificate for company engaged in construction.

xxv. Rent agreements

xxvi. Any other documents required for the audit, as above are not exhaustive

5(b) List of required documents for Lagos State Internal Revenue Service tax audit

i. Audited financial statements (AFS) /management accounts for the year(s) under review

ii. General ledger/trial balance

iii. Staff list with designation

iv. Payroll for local staff and expatriate staff

v. Schedule of company vehicles and designation

vi. Analysis of staff cost in the AFS

vii. Evidence of registration and monthly remittance of pension

viii. Evidence of registration and monthly remittance of National Housing Fund(NHF) and Nigeria Social Insurance Trust Fund (NSITF)

ix. Schedule of local and expatriate PAYE tax paid

x. Employment contracts of both temporary and permanent expatriate staff

xi. Letter of expatriate quota for the company

xii. Copies of monthly returns on expatriate to Immigration Service

xiii. Copies of expatriate deletion form

xiv. Payment advice to banks for local and expatriate staff

xv. Schedule of the company's operating and administrative expenses

xvi. List of suppliers/contractors including their addresses

xvii. Payment vouchers for the period under review

xviii. Rent schedule and rent agreement

xix. Schedule of withholding tax paid

xx. Names and address of directors

xxi. Schedule of payments made to directors

xxii. Copies of tax clearance certificate of directors

xxiii. List of the company offices, including headoffice

xxiv. Receipt for the business premises registration/renewal

xxv. Receipt for the development levy paid

xxvi. .Any other documents required for the audit, as the above

are not exhaustive

Professional level

Advanced Taxation

25

Ethics and professionalism in tax management

Contents

Ethics and professionalism in tax management

26.0 Purpose

After studying this chapter, readers should be able to:

(a) Understand the five fundamental principles and guidance in International Ethics Standards Board for Accountants (IESBA) codes;

(b) Understand the ethical issues that could arise from tax work;

(c) Explain the practical process to follow in addressing a tax violation under the Non-compliance with law and regulation (NOCLAR); and

(d) Know the code of ethics expected of Revenue officials and tax consultants.

26.1 Introduction

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a Chartered Accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest Chartered Accountants who are tax practioners should observe and comply with the ethical requirements of the professional code of conduct and guide.

In addition to the duties owed to the public and to his client or employer, a member of the Institute is bound to observe high standards of Professional conduct. These Rules are to aid members in the identification of occasions in which they might be at risk of failing to recognize or conform to any of those standards.

One of the principal objectives of the ICAN Act is to maintain high standards of professional practice and conduct by all members. The Act renders members liable to disciplinary action, inter alia, if in the course of carrying out their professional duties or otherwise, they commit any act or default likely to bring discredit to members, the Institute or the profession of accountancy. Believing that a high standard of practice and conduct is best maintained by such general provisions, the Council nonetheless considers it desirable to be more explicit in specific areas.

26.2 International Ethics Standards Board for Accountant (IESBA)

International Ethics Standards Board for Accountants (IESBA) is an independent standard-setting body within the International Federation of Accountants (IFAC).The IESBA develops and issues in the public interest high-quality ethics standards and other pronouncements for professional accountants for use around the world. It encourages member bodies to adopt high standards of ethics for their members and promotes good ethical practices globally. The IESBA also fosters international debate on ethical issues faced by accountants.

The mission of IFAC is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant.

26.3 The five fundamental principles and guidance for accountants (IESBA codes)

The fundamental principles of ethics as specified by the International Ethics Standards Board for Accountants (IESBA) are:

i. **Integrity**

A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships.

Integrity implies fair dealing and truthfulness. A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information contains materially false or misleading statement.

ii. **Objectivity**

A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others. A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

iii. **Professional competence and due care**

A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation and act diligently and in accordance with applicable technical and professional standards.

iv. **Confidentiality**

A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and business relationships.

The principle of confidentiality imposes an obligation on all professional accountants to refrain from:

(a) Disclosing outside the firm or employing organization confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and

(b) Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.

v. **Professional behavior**

A professional accountant shall comply with the principle of professional behavior, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession. A professional accountant shall not knowingly engage in any business, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

26.3.1 Justifications for appropriate legal action for non-compliance

Appropriate action for non-compliance with the fundamental principles of ethics is supported by:

(i) The power of the Institute to enforce ethical standards is derived from the Institute of Chartered Accountants of Nigeria Act No 15 of 1965. This power is conferred on the Accountants Disciplinary Tribunal. The Tribunal in this respect is independent of Council.

(ii) The Investigating Panel considers complaints against the conduct of members, and is empowered to initiate disciplinary action by referring appropriate cases to the Disciplinary Tribunal for adjudication.

(iii) Where a complaint is against the conduct of a firm having more than a partner, the complaint shall be deemed to have been made against each and every member who was partner in the said firm at the material time for the purposes of this scenario.

(iv) Any failure to follow the guidance in fundamental principles or in the statements shall also be taken into account by the Committee of the Institute responsible for regulating the work of members and member firms.

26.4 Possible legal and ethical issues arising from tax works

The following are the possible legal and ethical issues that could arise from tax works:

i. Technical competence - Failure of tax practitioners to maintain an appropriate level of professional competence by ongoing development of their knowledge and skills.

ii. Reasonable Enquiry - Failure to make reasonable enquiries where information or documentation as furnished by a client appears to be inaccurate or incomplete.

iii. Continue to act - Continuing to act for a client in circumstances where incorrect or misleading information is not corrected by the client
iv. Tax avoidance - Conflicts which arise in distinguishing between legitimate tax planning/tax minimisation arrangements and tax avoidance activities/schemes.
v. Supervision of tax audit - Failure to carefully plan for or otherwise supervise on behalf of the client, audit activities carried out by tax authorities.
vi. Tax loopholes - "Loophole seeking" to deliberately test the boundaries of tax law.
vii. Fee setting - Basing the amount of the fee charged for tax services on the amount of tax saved/tax liability i.e., contingent fee setting.
viii. Aggressive interpretation - Adoption of overly aggressive interpretations of questionable issues and reporting positions on the basis that detection of the issue by the tax authorities is unlikely i.e., playing the "tax audit lottery".
ix. Misleading advice - Provision of inadequate or misleading advice to clients as to the potential risks and consequences of adopting various reporting positions and tax arrangements.
x. Misrepresentation - Misrepresenting or concealing limitations in a tax practitioner's competence or skills to perform particular tax services.
xi. Personal gain - Conflicts between opportunities for personal financial gain (or other personal benefit) and proper performance of a tax practitioner's responsibilities.
xii. Conflict of interest - Conflicts of interest that involve providing services to competing clients such that the interests of one client may be prejudiced.
xiii. Documentation - Preparing and signing a return without seeing full documentation
xiv. Communication - Failure to communicate to clients unfavourable as well as favourable information and professional opinions.
xv. Tax authority's errors - Inaction by the tax practitioner in respect of a clear and significant mathematical or clerical mistake by the relevant tax authorities in favour of a client.
xvi. Reporting position - Determining whether the client or the tax practitioner should make the final reporting decisions for contentious or ambiguous items.

xvii. Public responsibility - Failure to acknowledge a public responsibility to contribute to the improvement of the tax laws and their administration e.g., reporting blatant tax avoidance arrangements.

xviii. Professional judgment - Carrying out a client' s instructions which are inconsistent with the professional judgment of the tax practitioner. (Professional judgment)

xix. Poaching clients - Poaching or soliciting potential clients from other practitioners/practices.

xx. Authority - Dealing with a client’s funds (e.g., a tax refund cheque) without client authority. (Authority)

xxi. Tax audit - Structuring a transaction, or the preparation of a tax return in such a way as to reduce the chances of a tax audit.

xxii. Research - Failure to conduct adequate research on a problem as a reasonable basis for identifying issues and forming carefully considered conclusions and recommendations.

xxiii. Prior years errors - Inaction by the tax practitioner in respect of a clear and significant error detected in a client' s prior year return(s). (Prior year errors)

xxiv. Confidentiality - Failure to ensure confidentiality with regard to privileged client information.

xxv. Tax minimization - Keeping a client informed of current tax minimisation arrangements which have no real commercial or family purpose.

26.5 Significance of legal and ethical issues in preparation of returns and in reporting

Professional accountants in tax practice must take note of legal and ethical issues when preparing tax returns. Non- adherence could lead to following consequences from the professional body:

- ✓ Imposition of Fines
- ✓ Suspension from membership of the Institute for a period of time
- ✓ Expulsion from membership of the Institute
- ✓ Withdrawal of Certificate and Licence to Practice
- ✓ Reprimand
- ✓ Payment of costs associated with the investigations and meetings

26.6 Designing ethical safeguards against threats from employers, clients, government agencies and other stakeholders

Threats

A professional accountant in public practice shall not knowingly engage in any business, occupation, or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the fundamental principles.

Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances and relationships.

Threats fall into one or more of the following categories:

(a) Self-interest - The threat that a financial or other interest will inappropriately influence the professional accountant’s judgment or behavior. For instance, a firm having undue dependence on total fees from a client.

(b) Self-review - The threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of providing a current service.

(c) Advocacy - The threat that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised.

(d) Familiarity -The threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work

(e) Intimidation - The threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant. For instance a firm being threatened with dismissal from a client engagement

Safeguards against threats:

Safeguards are actions or other measures that may eliminate threats or reduce them to an acceptable level. They fall into two broad categories:

(a) Safeguards created by the profession, legislation or regulation – This includes:

i. **Continue professional development requirement**

ii. **Professional standards**

iii. **Corporate governance regulations**

(b) Safeguards in the work environment – This include:

- **Leadership and transparency**
- **Recruitment procedures for high caliber staff**

26.7 Non-compliance with law and Regulation (NOCLAR) principles

26.7.1 Framework as a professional accountants

In providing a professional service to a client or carrying out professional activities for an employer, Professional Accountants (PAs) come across various acts or suspected acts of non-compliance with laws and regulations (NOCLAR). The Professional Accountants (PAs) has a prima facie ethical responsibility not to turn a blind eye to such matters. At the same time, the International Ethics Standards Board for Accountants (IESBA) recognized that such a situation can often be a difficult and stressful one. In order to provide a solution to the dilemma, the Board approved the NOCLAR pronouncement to develop enhancements to the IESBA Code to help guide the PAs in dealing with the situation and in deciding how best to act in the public interest. When responding to non-compliance or suspected non-compliance, the objective of the professional accountant should be to comply with fundamental principles of integrity and professional behaviours while taking public interest into consideration. In addition, the aim of response by PAs is for the entity to correct the NOCLAR and remediate or prevent its occurrence where it is still being suspected.

26.7.2 Practical process to address tax laws violation by professional accountants in tax

practice

When a professional accountant in tax practice becomes aware of a non-compliance or suspected noncompliance with provisions of tax laws, the following process/ steps are to be taken.

- Become aware (see it, but do not seek it)
- Obtain an understanding of the matter
- Address the issue with management and those charged with governance
- Communicate the matter to the entity's external auditor
- Consider whether further action is needed in the public interest e.g. disclosing to authorities or withdrawing from the engagement
- Documentation i.e. the matter, result of discussion with management or those charged with governance, actions taken

26.8.3 Practical process to address tax laws violation by professional accountants in business

Professional Accountants other than Senior Professional Accountants

When an organizations have established protocols and procedures regarding how noncompliance or suspected noncompliance should be raised internally. The professional accountant is expected to consider them in determining how to handle non-compliance.

- Subject to established protocols and procedures, inform an immediate superior to enable the superior to take appropriate action.
- If the PA's immediate superior appears to be involved in the matter, inform the next higher level of authority within the organisation.
- In exceptional circumstances, the PA may decide that disclosure of the matter to an appropriate authority is an appropriate course of action.
- Documentation i.e. matter, discussion, response by superior, and decision taken.

Senior Professional Accountants (SPAs)

SPAs are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of human, financial, technological, physical and intangible resources

- Become aware (see it, but do not seek it)
- Obtain the understanding of the matter
- Address the matter
- Determine whether further action is needed
- Determine whether to disclose the matter to an appropriate authority
- Documentations

26.8 Chapter review

In this chapter, readers must have learnt the following:

The five fundamental principles and guidelines for accountants (IESBA codes);
Nature of threats to compliance with IESBA codes and the safeguards; and
Identify key requirements, obligations and impact of NOCLAR on professional accountants

26.9 Worked examples

26.9.1 Open-ended questions

(1) a. Analyse and evaluate any FOUR fundamental principles of ethical standards as provided in the Institute of Chartered Accountants of Nigeria‟s Code of Professional Conduct for Accountants.

b. Outline the penalties for a member‟s unethical behaviour.

c. Outline the powers available to the Institute to enforce the ethical standards.

(2) a. Examines eight (8) ethical issues that could arise from tax engagement

b. Identify the process that could be followed by professional accountants in practice to address violation with tax laws.

(3) Professional Accountants (PAs) do come across various acts or suspected acts of non-compliance with laws and regulations (NOCLAR) in the course of their engagement.

Required:

(a) Briefly explain the International Ethics Standards Board for Accountants (IESBA) approved pronouncement on dealing with NOCLAR.

(b) Identify practical process to be taken by Professional Accountants other than Senior Professional Accountants when tax laws violation are observed in the course of their engagement.

26.10.2 Suggested solutions to open-ended questions

(1) (a) Fundamental Principles of ethical standards as provided in the Institute of Chartered Accountants of Nigeria‟s Code of Professional Conduct for Accountants are:

i) **Integrity**

A Chartered Accountant should be straightforward and honest in all professional and business relationships. Integrity implies not merely honest, but fair dealing and truthfulness.

ii) Objectivity is the state of mind, which has regard to all considerations relevant to the task at hand, but no other consideration. A Chartered Accountant should not allow bias, conflict of interest or undue influence to override his professional or business judgment.

iii) **Professional competence and due care**

A chartered accountant has a continuing duty to maintain professional knowledge and skills at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A member should not accept or perform work, which he is not competent to undertake unless he obtains such advice and assistance as will enable him to do so. A Chartered Accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services. A member should carry out his professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of him as a member.

iv) **Confidentiality**

A chartered accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any of such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the chartered accountant or third party.

v) **Professional behaviour**

A chartered accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession. A member should conduct himself with courtesy and consideration towards all with whom he comes in contact with in the course of performing his work.

(b) **Penalties for a member's unethical behavior include:**

i. Imposition of fines;
ii. Suspension from membership of the Institute for a period of time ;
iii. Expulsion from membership of the Institute;
iv. Withdrawal of certificate and licence to practice;
v. Reprimand ; and
vi. Payment of costs associated with the investigations and meetings.

(c) **Enforcement of ethical standards**

(i) The power of the Institute to enforce ethical standards is derived from the Institute of Chartered Accountants of Nigeria Act No 15 of 1965. This power is conferred on the Accountants Disciplinary Tribunal. The Tribunal in this respect is independent of Council.
(ii) The Investigating Panel considers complaints against the conduct of members, and is empowered to initiate disciplinary action by referring appropriate cases to the Disciplinary Tribunal for adjudication.
(iii) Where a complaint is against the conduct of a firm having more than a partner, the complaint shall be deemed to have been made against each and every member who was partner in the said firm at the material time for the purposes of this scenario.
(iv) Any failure to follow the guidance in fundamental principles or in the statements shall also be taken into account by the Committee of the Institute responsible for regulating the work of members and member firms.

(2) a The following ethical issues could arise from tax engagement:

i. Technical competence - Failure of tax practitioners to maintain an appropriate level of professional competence by ongoing development of their knowledge and skills;
ii. Reasonable Enquiry - Failure to make reasonable enquiries where information or documentation as furnished by a client appears to be inaccurate or incomplete;
iii. Continue to act - Continuing to act for a client in circumstances where incorrect or misleading information is not corrected by the client;
iv. Tax avoidance - Conflicts which arise in distinguishing between legitimate tax planning/tax minimisation arrangements and tax avoidance activities/schemes;
v. Supervision of tax audit - Failure to carefully plan for or otherwise supervise on behalf of the client, audit activities carried out by tax authorities.;
vi. Tax loopholes - "Loophole seeking" to deliberately test the boundaries of tax law;
vii. Fee setting - Basing the amount of the fee charged for tax services on the amount of tax saved/tax liability i.e., contingent fee setting;
viii. Aggressive interpretation - Adoption of overly aggressive interpretations of questionable issues and reporting positions on the basis that detection of the issue by the tax authorities is unlikely i.e., playing the "tax audit lottery";

ix. Misleading advice - Provision of inadequate or misleading advice to clients as to the potential risks and consequences of adopting various reporting positions and tax arrangements;

x. Misrepresentation - Misrepresenting or concealing limitations in a tax practitioner' s competence or skills to perform particular tax services;

xi. Personal gain - Conflicts between opportunities for personal financial gain (or other personal benefit) and proper performance of a tax practitioner' s responsibilities;

xii. Conflict of interest - Conflicts of interest that involve providing services to competing clients such that the interests of one client may be prejudiced;

xiii. Documentation - Preparing and signing a return without seeing full documentation;

xiv. Communication - Failure to communicate to clients unfavourable as well as favourable information and professional opinions;

xv. Tax authority's errors - Inaction by the tax practitioner in respect of a clear and significant mathematical or clerical mistake by the relevant tax authorities in favour of a client.;

xvi. Reporting position - Determining whether the client or the tax practitioner should make the final reporting decisions for contentious or ambiguous items;

xvii. Public responsibility - Failure to acknowledge a public responsibility to contribute to the improvement of the tax laws and their administration e.g., reporting blatant tax avoidance arrangements;

xviii. Professional judgment - Carrying out a client's instructions which are inconsistent with the professional judgment of the tax practitioner. (Professional judgment);

xix. Poaching clients - Poaching or soliciting potential clients from other practitioners/practices;

xx. Authority - Dealing with a client' s funds (e.g., a tax refund cheque) without client authority. (Authority) ;

xxi. Tax audit - Structuring a transaction, or the preparation of a tax return in such a way as to reduce the chances of a tax audit;

xxii. Research - Failure to conduct adequate research on a problem as a reasonable basis for identifying issues and forming carefully considered conclusions and recommendations;

xxiii. Prior years errors - Inaction by the tax practitioner in respect of a clear and significant error detected in a client's prior year return(s). (Prior year errors);

xxiv. Confidentiality - Failure to ensure confidentiality with regard to privileged client information; and

xxv. Tax minimization - Keeping a client informed of current tax minimisation arrangements which have no real commercial or family purpose.

(b) When a professional accountant in tax practice becomes aware of a non-compliance or suspected noncompliance with provisions of tax laws, the following process/ steps are to be taken.

- Become aware (see it, but do not seek it)
- Obtain an understanding of the matter
- Address the issue with management and those charged with governance
- Communicate the matter to the entity's external auditor
- Consider whether further action is needed in the public interest e.g. disclosing to authorities or withdrawing from the engagement
- Documentation i.e. the matter, result of discussion with management or those charged with governance, actions taken

(3) (a) In the rendering professional service to a client or carrying out professional activities for an employer, professional accountants (PAs) could come across various acts or suspected acts of non-compliance with laws and regulations (NOCLAR).

The professional accountants (PAs) has a prima facie ethical responsibility not to turn a blind eye to such matters. At the same time, the International Ethics Standards Board for Accountants (IESBA) recognized that such a situation can often be a difficult and stressful one. In order to provide a solution to the dilemma, the Board approved the NOCLAR pronouncement to develop enhancements to the IESBA Code to help guide the PAs in dealing with the situation and in deciding how best to act in the public interest.

When responding to non-compliance or suspected non-compliance, the objective of the professional accountant should be to comply with fundamental principles of integrity and professional behaviours while taking public interest into consideration. In addition, the aim of response by PAs is for the entity to correct the NOCLAR and remediate or prevent its occurrence where it is still being suspected.

(c) The following are the steps to be taken by professional accountants (PAs) other than senior professional accountants (SPAs) when tax laws violation are observed in the course of their engagement.

When an organizations have established protocols and procedures regarding how noncompliance or suspected noncompliance should be raised internally. The professional accountant is expected to consider them in determining how to handle non-compliance.
Other steps are:

- Subject to established protocols and procedures, inform an immediate superior to enable the superior to take appropriate action.
- If the PA's immediate superior appears to be involved in the matter, inform the next higher level of authority within the organisation.
- In exceptional circumstances, the PA may decide that disclosure of the matter to an appropriate authority is an appropriate course of action.
- Documentation i.e. matter, discussion, response by superior, and decision taken.

Professional level

Advanced Taxation

27

Tax accounting and reporting

Contents

Tax accounting and reporting

27.0 Purpose

After studying this chapter, readers should be able to:

(a) Appreciate the nature of accounting for taxes;

(b) Understand accounting entries with respect to tax;

(c) Know the disclosure requirements; and

(d) Know how to present tax account in financial statements.

27.1 Nature of tax account

The tax accounts of a company are used to record movements in the company's tax transactions for each year. For clarity, it is highly recommended that a separate account be maintained for each type of tax in the company's ledger. A typical tax account of a company contains the following:

(a)	Unpaid taxes at the beginning of the year	- opening balance	- CR
(b)	Provision for companies income tax	- current year	- CR
(c)	Provision for tertiary education tax	- current year	- CR
(d)	Prior year under-provision for tax	- previous year(s)	- CR
(e)	Prior year over-provision for tax	- previous year	- DR
(f)	Provision for deferred tax liabilities on timing differences	- current year	- CR
(g)	Provision for deferred tax assets on timing differences	- current year	- DR
(h)	Tax payments during the year		- DR
(i)	Withholding tax credit notes set-off		- DR
(j)	Unpaid taxes at the end of the year	- closing balance	- CR

27.2 Posting into the tax account

Entries in the tax account are posted by raising the following journals:

(a) **Provision for income tax**

Profit and loss account

DR

Tax account

CR

Being provision for income tax for the year based on 30% of the total profit

(b) **Provision for tertiary education tax**

Profit and loss account

DR

Tax account

CR

Being provision for tertiary education tax at 2% of assess able profit.

(c) **Under provision for tax in the prior year**

Profit and loss account

DR

Tax account

CR

Being prior year under-provision for Income tax.

(d) **Over provision for tax in the prior year**

Tax account

DR

Profit and loss account

CR

Being prior year over provision for Income tax.

(e) **Cash payment of taxes**

Tax account

DR

Bank

CR

Being payment on account of outstanding income tax and education tax liabilities for year

(f) **Offset of income tax with withholding tax credit notes**

Income tax account

DR

Withholding tax account (receivable)

CR

Being set-off of withholding tax suffered at source against income tax liabilities for the year.

27.3 Deferred tax

Deferred tax is the tax attributable to timing differences. It could be deferred tax assets or deferred tax liability. Deferred tax assets are the amounts of taxes recoverable in future periods which are attributable to temporary differences. Deferred tax liabilities are the taxes payable in future accounting periods attributable to temporary differences. The objective of providing for deferred taxes is to ensure that the tax expense reported in an income statement of a particular period reflects the tax effects of transactions included in the accounting profit/loss of the period.

Permanent differences are not taken into consideration as they do not affect other periods.

27.3.1 Computation and accounting for deferred taxes (IFRS)

Deferred tax is computed by multiplying the difference between the tax base (e.g. TWDV of property, plant and equipment (PPE)) and the carrying amounts (e.g. NBV of PPE) by the ruling company income tax rate of 30%. Postings into deferred tax account are done by raising the following journals:

(a) **Provision for deferred tax liabilities on timing differences**

Profit and loss account

DR

Deferred tax account

CR

Being provision charged for deferred tax liabilities on timing differences.

(b) **Provision for deferred tax assets on timing differences**

Deferred tax account

DR

Profit and loss account

CR

Being provision charged for deferred tax assets on temporary differences.

Illustration:

Where there is no revaluation surplus

Deferred Tax Asset (DTA) = Tax written down value (TWDV) less Net book value (NBV) or carrying amount x 30% e.g TWDV is 500m while NBV is N420m. DTA will be (500m-420m) x 30% =N24m

DTL = NBV less TWDV x 30% e.g NBV is N900m while TWDV is N350. DTL will be (900m-350m) x 30% =N165m

Where there is revaluation surplus

DTA = (TWDV less NBV less revaluation surplus)x 30% e.g TWDV is 500m, NBV is N420m and revaluation surplus is N50m. DTA will be (500m-370m) x 30% =N39m

Note: N370m = N420m less N50m

DTL = (NBV less revaluation surplus less TWDV) x 30% e.g NBV is N900m, revaluation surplus is N120m while TWDV is N350. DTL will be (900m-N120m-350m) x 30% =N129m

27.4 Disclosure of taxes in financial statements

Companies are required to disclose the components of tax expenses, tax assets and liabilities in the financial statements. Such disclosures are usually made in the financial statements by way of notes.

27.5 Presentation of taxes in financial statements

The note on taxation is usually presented in the financial statements in a vertical form, as follows:

	₦'000
Income tax on profit before tax	x
Tertiary education tax (2% of assessable profit)	x
Prior year's under provision for income tax	x
Deferred tax liability (charge)	x
Per profit or loss account	xx
Outstanding at the beginning of the year	x
Adjustment for deferred tax charge	(x)
Payments during the year	(x)
Per statement of financial position	xx

27.6 Risks of wrong or misleading tax disclosure

Financial statements are prepared in accordance with a financial reporting framework. The term financial reporting framework is defined as "a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements". Examples of financial reporting frameworks are generally accepted accounting principles (GAAP) in the United States of America, International Financial Reporting Standards (IFRSs), and other financial reporting framework in other jurisdictions.

The essence of the financial reporting framework is to ensure standardization that will engender faithful representation and comparability.

Taxes (both current and deferred) are one of the disclosures in the financial statements. Therefore, taxes should be fairly disclosed in the financial statements to ensure that users of financial statements are well informed and not mislead by wrong tax disclosures.

Meanwhile, since tax expert and professionals make use of the financial statements generated using accounting principles and standards, care should be taken on the level of reliance placed on financial statements to ensure that the risk of wrong or misleading tax disclosure are mitigated.

27.7 Chapter review

This chapter covers sequence of accounting entries required and necessary to record the tax transactions of a company. It provides the disclosure requirements with regards to components of tax expenses to be detailed in notes to the financial statements.

27.8 Worked examples

27.8.1 Open-ended questions

(1) Isiaka Jimoh Limited is a company engaged in manufacturing of imirat oil. Its accounts for the year ended September 30, 2017, revealed the following results:

	₦'000
Net profit for the year	300,000
after charging:	
Depreciation of prop., plant and equip.	22,500
Loss on sale of prop., plant and equip.	500
Penalty and fine	200
Loan interest	8,500
Salaries and wages	30,000
and crediting:	
Franked Investment Income	20,000
Interest on foreign deposit a/c repatriated	5,600

Additional information:

(i) The company has unrelieved losses of ₦15 million

(ii) Capital allowances claim amounted to ₦55 million

(iii) The tax written down value of fixed assets as at 30 September 2017, after the above capital allowances have been taken into account was ₦620million while the net book value on the same date was ₦550million. The opening tax written down values and net book values were ₦665million and ₦630 million respectively.

(iv) Unpaid tax at the beginning of the year was ₦52 million while payment in the year was ₦60 million.

(v) Assume a depreciation rate of 5% per annum on property, plant and equipment.

(vi) The company revalued its property, plant and Equipment during the year ended September 30, 2012. The revaluation surplus arising from the revaluation which amounted to ₦100 million was reflected in the company's financial statements for that year.

Given the information above, you are required to:

(a) Compute the company's tax liabilities for the relevant year of assessment

(b) Compute the Deferred tax

(2) (a) Define deferred tax

(b) Explain how entries are made into the tax account

(3) Ojeaga Limited is a financial institution based in Europe. The audited financial statements of the company for the year ended December 31, 2015, revealed the following:

	1/1/2015	31/1/2015
	₦'million	₦'million
Net book value of equipment	625	720
Tax written down value of equipment	651	808
Outstanding tax	78	63
The company recorded a net profit of N660 million		
After charging:		₦'million
Depreciation of equipment		17
Stamp duties		2
Interest and bank charge		15
Staff costs		42
The profit for the year also included:		
Profit on sale of equipment		4
Franked investment income		25

The company has unrelieved losses brought forward of ₦10 million and capital allowances of ₦60 million for the year. The company also revalued its property (land and building) on July 31, 2012 with a revaluation surplus of ₦120 million which has been incorporated into its accounts as at that point in time. The company's depreciation rate on the property is 10% per annum.

You are required to:

Compute the company's tax liabilities for the relevant tax year, with note to the financial statements in line with the provision of relevant accounting standards.

(4) You are required to show the journal entries for the treatment of the following transactions:

i. Education tax per accounts amounted to ₦2,800,000

ii. Income tax under-provided for by ₦500,000

iii. ₦2,750,000 paid as part of outstanding income tax

iv. Provision for deferred taxes liability on timing differences of ₦570,000

27.8.2 Suggested Solutions to open-ended questions

1 (a) **Isiaka Jimoh Limited Computation of tax liabilities Assessment year 2018**

	₦'000	₦'000
Net Profit per accounts		300,000
Add:		
Depreciation		22,500
Loss on sale of plant and equipment		500
Penalties and fines		200
		323,200
Deduct:		
Franked investment	20,000	
Repatriated interest	5,600	(25,600)
Adjusted/assessable profit		297,600
Deduct:		
Unrelieved losses brought forward		(15,000)
		282,600
Capital allowances		(55,000)
Total profit		**227,600**

Taxes payable
Companies income tax– (₦227,600) at 30% = ₦68,280
Tertiary education tax – (₦297,600)at2% = ₦5,952

(b) **Computation of deferred tax Assessment year 2018**

		2018			2017	
	₦'000	₦'000	₦000	₦000	₦'000	₦'000
Tax written down value		620			665	
Less:						
Net book values		550			630	
Deduct:						
Revaluation surplus		100			100	
Less:						
Depreciation 2018						
₦100m at 5% p.a.x 6yrs	(30)	(70)	(480)			
Depreciation2017						
₦100m at 5% p.a. x 5 years			(25)		(75)	(555)
Timing difference		140			110	

Deferred tax provision thereonat30%	42	33

Additional provision for deferred tax assets for the year (N42,000 – N33,000) = N9,000

Notes to the accounts

Taxation	₦'000
Income tax based on profit for the year	68,280
Tertiary edu. Tax based on 2% of ass .profits	5,952
Deferred tax credit	(9,000)
Per statement of profit or loss	**65,232**
Unpaid taxes at the beginning of the year	52,000
Income tax based on profit for the year	68,280
Tertiary edu. taxbased on 2% of ass. Profits	5,952
Payments in the year	(60,000)
Per statement of financial position	**66,232**

Deferred tax assets account

	₦' million
Balance asat1/10/2016	33
Additional credit/provision during the year	9
Balance asat30/09/2017	42

(2) (a) Deferred taxation which is provided for by the liability method represents taxation at the current rate of companies income tax and the difference between the carrying values of the assets and their corresponding tax base. Deferred tax liability should be recognised for all taxable temporary difference and charged to the income statement. A deferred tax asset should be recognised to the extent that it is probable that taxable profit will be available in the future against which to recover tax or reduce liability.

(b) Entries are made into the tax account by raising the following journals:

(i) **Provision for income tax**

Profit and loss account	DR
Tax account	CR

Being provision for income tax for the year based on 30% of the total profit.

(ii) **Provision for tertiary education tax**

Profit and loss account	DR
Tax account	CR

Being provision for tertiary education tax at 2% of assessable profit.

(iii) **Under provision for tax in the prior year**

Profit and loss account	DR
Tax account	CR

Being prior year under-provision for Income tax.

(iv) **Over provision for tax in the prioryear**

Tax account	DR
Profit and loss account	CR

Being prior year over provision for Income tax.

(v) **Cash payment of taxes**

Tax account	DR
Bank	CR

Being payment on account of outstanding income tax and education tax liabilities for the year

(vi) **Offset of income tax with withholding tax credit notes**

Income tax account	DR
Withholding tax account (receivable)	CR

Being set-off of withholding tax suffered at source against income tax liabilities for the year.

(vii) **Provision for deferred tax liabilities on timing differences**

Profit and loss account	DR
Deferred tax account	CR

Being provision charged for deferred tax liabilities on timing differences.

(viii) **Provision for deferred tax assets on timing differences**

Deferred tax account	DR
Profit and loss account	CR

Being deferred tax assets provision on temporary differences.

(3) **Ojeaga Limited**

Computation of tax liabilities for 2016 tax year

	₦' million	₦' million
Net profit for the year		660
Add: Disallowable expenses		
Depreciation	17	
Stamp duties	2	19
		679
Less: Profit on sale of property	4	
Franked investment income	25	29
Assessable profit		650
Less: Unrelieved losses b/f		10
		640
Less: Capital allowances		60
Total profit		580
Companies income tax (30% of N580 million)		174
Tertiary education tax (2% of N650 million)		13

Computation of deferred tax for 2016 tax year

	₦' million	₦' million
Tax base(TWDV)	808	651
Less: Carrying value(NBV)	(648)	(541)
Temporary difference	160	110
Deferred tax provision@30%	48	33

Additional provision for the year
(N48 million –33million) = N15million.

Notes to the accounts

Taxation account

	₦' million
Companies income tax provision	174
Tertiary Education tax provision	13
Deferred tax credit	(15)
Charged to profit and loss accounts	172
Outstanding tax asat1/1/2017	78
Companies income tax provision	174
Tertiary Education tax provision	13
	265
Outstanding tax asat31/12/2017	(63)
Tax paid during the year	202

Deferred tax assets account

	₦' million
Balance asat1/1/2017	33
Additional credit/provision during the year	15
Balance asat31/12/2017	48

Workings

1. **Calculation of net book value**

	2016		2015	
	₦' million	₦' million	₦' million	₦' million
Net book value as per accounts		720		625
Less: Revaluation surplus	120		120	
Depreciation	(48)		(36)	
		72		84
		648		541

2. **Depreciation on revaluation surplus**

2016 tax year: 10% of ₦120 million x 4 = ₦48million
2015 tax year: 10% of ₦120 million x 3 = ₦36million

3. (a) Dr Profit and Loss Account ₦2,800,000
Cr Provision for Education Tax Account ₦2,800,000

(b) Dr Profit and loss Account ₦500,000
Cr Provision for Income Tax Account ₦500,000

(c) Dr Income Tax Provision Account ₦2,750,000
Cr Bank ₦2,750,000

(d) Dr Profit and loss Account ₦570,000
Cr Deferred Tax Account ₦570,000

28

Oil and gas taxation

Contents

28.0 Purpose

After studying this chapter, readers should be able to:

- have a good appreciation of the development of Nigeria's petroleum sector and how it evolved overtime;
- appreciate the meaning of upstream and downstream activities;
- know all the elements and agencies involved in the regulation of the
- petroleum profit tax (PPT);
- be conversant with definitions of some relevant terms used in the
- petroleum industry;
- be conversant with the administrative procedure Petroleum Profit
- Tax;
- Know the relevant costs classification obtainable in the computation of the Petroleum Profit Tax;
- Know the procedure for the computation of the petroleum profit tax;

- Know the makeup and the procedure for calculation of capital allowance;
- Know the purpose of the terms 'Posted Price' and 'Adjusted Posted Price' in the determination of the value for chargeable oil for tax purpose;
- Appreciates the main Tax offsets items– MOU and ITC- and their treatment in the process of computing the Petroleum Profit Tax;
- Know the circumstances giving rise to additional tax and how it is computed;
- Conversant with the tax assessment and appeal procedure;
- Know the procedure for collection and payment of the Petroleum Profit Tax; and
- Know the process of computing tax on sale of

28.1 Introduction

Nigeria produces about two million barrels of crude oil per day and is ranked among the top twenty largest producers in the world. The oil and gas sector accounts for about 60% of government's total revenue and more than 90% of its foreign exchange receipts. All the tiers of government depend on this. Nigerian oil reserves are estimated at over 37 billion barrels.

In addition to its crude oil reserves, Nigeria is endowed with abundant reserves of natural gas. The large deposit of gas encountered in the search for oil has led many experts to describe the Nigerian petroleum fields as a gas province with some oil in it. The proportion of natural gas in conjunction with crude oil is relatively high. Today Nigeria's natural gas reserves have been estimated at over 192 trillion standard cubic feet.

Within the last decade some of the existing operators in the petroleum sector in joint venture with the Nigerian National Petroleum Corporation (NNPC) have embarked on a number of gas utilisation projects. Most of these projects however, are in relation to associated gas discovered in the search for oil, whilst unassociated gas deposits are being reserved for future investment.

28.2 General overview of oil and gas industry in Nigeria

In 1908, a German company called "The Nigerian Bitumen Company" began the search for crude oil in Nigeria. The license granted was for exploration of Petroleum at Araromi in the present-day Ondo State. The outbreak of the First World War in 1914 brought a halt to this adventure. The company did not resume operations after the war because of the discouraging results during its operating period.

In 1937, Shell D'Arcy was granted exploration licenses to cover the entire Nation. This adventure again was suspended at the outbreak of the Second World War in 1941 only to resume later in 1946. It was the amalgamation of Shell D'Arcy and British Petroleum (BP) that gave rise to Shell Petroleum Development Nigeria Limited which eventually discovered oil in commercial quantity after a decade i.e 1956 at Oloibiri in the present-day Niger Delta area of the country. The first oil field began production in 1958. Oil was discovered later in other areas of both Rivers and Bayelsa States.

The Shell BP, an Anglo/Dutch Company initially had the monopoly of oil prospecting in Nigeria, but was later joined by other oil companies like Mobil, Texaco Overseas, Agip and Gulf.

Petroleum activities are grouped under two categories, Upstream and Downstream.

The Oil industry has achieved great prominence in the Nigerian economic environment since the early seventies. The influence of oil and gas on the Nigerian economy today cannot be over emphasised.

It is in view of this importance that Government attaches to oil exploration and production that the taxation of profits or gains of companies engaging in such operations are taxable under a separate tax law. The applicable law is the Petroleum Profits Tax Act (PPTA), which was first enacted in 1959 with retrospective effective date of 1 January, 1958. This principal Act and all amendments thereto have been re-enacted as Chapter P13 of the Laws of the Federation of Nigeria (LFN) 2004.

'Petroleum operations' as defined in the Act essentially involves petroleum exploration, development, production and sale of crude oil and gas. There is no distinction in the Act between associated and non- associated gas. All activities of petroleum companies that are to be taxed under PPTA are referred to as Upstream operations. Those that are not covered under the definition of "petroleum operations" are referred to as downstream operations. Examples of downstream operations are petroleum refining, petroleum marketing and gas utilisation projects. Companies engaged in downstream operations are subject to tax under the Companies Income Tax Act Cap C21 LFN 2004.

PPTA provides a framework for the understanding of the Nigerian petroleum tax regime. Recourse must still be made to the various contractual arrangements, Memoranda of Understanding and side letters that provide information on the incentives made available by Government to the operators in the oil and gas industry. These are additional to the provisions of the PPTA and are usually applied as if they were part of the provisions of the Act.

28.3 Roles of regulatory agencies in the oil and gas industry

28.3.1 Nigerian National Petroleum Cooperation (NNPC)

Nigerian National Petroleum Corporation (NNPC) This was established by Act No 33 of 1 April 1977. NNPC is the sole authority over the petroleum activities in Nigeria.

NNPC through its subsidiaries is involved in exploration, production, transportation, processing of oil, refining, marketing of crude oil and derivatives.

Subsidiaries of Nigeria National Petroleum Company:

(i) National Petroleum Investment Management Services (NAPIMS) – This is the investment arm of NNPC which administers NNPC share of joint venture operations.

(ii) The Petroleum Products Marketing Companies (PPMC) – These companies have the responsibility of selling refined petroleum and finished products which include gasoline, diesel, engine oil, grease and other derivatives.

(iii) Nigerian Petroleum Development Company (NPDC) – This is the arm of NNPC that is engaged in the following areas:

- Exploration – Seismic acquisition/processing – analysis exploratory, drilling and testing;
- Appraisal –Drilling of appraisal wells, re-evaluation survey, testing, etc.;

- Development – Drilling/development of wells, production, optimisation, well engineering and field survey;

- Production - Intervention and stimulation of production optimisation;

- Abandonment – Environmental impact assessment (EIA) effluent monitoring, testing/facilities demobilisation, remediation and decommissioning; and

- NPDC has Joint Partners e.g. Shell Petroleum Development Company and Chevron Nigeria Limited (SPDC and CNL) and Service Contract Partners.

(v) The Nigerian Petrochemical Companies in Kaduna and Warri.

(vi) The Refineries (2 in Port Harcourt) one each in Warri and Kaduna.

28.3.2 National Petroleum Investment Management Services (NAPIMS)

This is the investment arm of NNPC which administers NNPC share of joint venture operations.

NAPIMS manages the Federal Government of Nigeria (FGN) interests in the oil and gas industry. Therefore, the roles and responsibilities of NAPIMS can be defined as follows:

- Management of Nigeria Government Assets
- Prosecution of Nigeria Government Agenda
- Defining operational direction and
- Spearheading new technology application in the oil and gas industry

28.3.3 Department of Petroleum Resources (DPR)

This is the arm of the Ministry of Petroleum Resources that is charged with the responsibility of regulation and supervision of all operations under licence and leases in the oil and gas industries which includes exploration, production and marketing of crude oil and refined petroleum products.

The roles of DPR includes:

- Issue approvals and licences for Refineries, Petrochemicals, Fertilizer Plants, Jetties, Depots, Lube blending and Retail Outlet
- Ensure prompt nomination of crude, condensate & NGL export vessels
- Ensure integrity of downstream Oil and Gas facilities and pipeline systems
- Ensure measurement integrity at custody transfer points
- Issue import permit and clearance for petroleum products
- Issue export permits for crude oil and petroleum products
- Determine the quality of imported petroleum products to ensure they meet established standards.
- Implement government policies on Upstream Oil and Gas matters.

28.3.4 Federal Inland Revenue Service (FIRS)

The Federal Inland Revenue Service (FIRS) collects the petroleum profit tax on behalf of the Federal Government of Nigeria.

The powers and duties of the FIRS with respect to the administration of Petroleum Profit Tax Act Cap P13 LFN 2004 are stated under section 3 of the Act. The schedule specifically highlighted the powers and duties that cannot be delegated by the FIRS under sections 3(b), (d) and (e); 6(2); 10(1)(k); 13(3) (c); 15, 31(2); 33(1); 37(1); 49, 52, 53 and 58 of the Act.

28.3.5 Central Bank of Nigeria (CBN)

Sale of crude oil is paid for in foreign currency into Federal Government designated bank overseas: The proceed is then transferred into the Federation Account in the Central Bank of Nigeria and Federal Inland Revenue Service is notified through payment advice.

28.4 Effects of the provisions of the petroleum industry governance bill (PIGB)

Since the introduction of the Petroleum Industry Bill (PIB) in 2008, there have been various amendments of it and deliberations about it. In 2017, four new pieces of legislation were created, namely: the Petroleum Industry Governance Bill (PIGB), the Petroleum Industry Administration Bill (PIAB), the Petroleum Industry Fiscal Bill (PIFB) and the Petroleum Host Society Bill (PHCB).

As stated above, the Petroleum Industry Governance Bill (PIGB) is a subset of the Petroleum Industry Bill (PIB) aimed at reforming Nigeria's oil and gas sector. The PIGB focuses on the governance of the oil & gas sector and seeks to promote transparency and accountability in the administration of petroleum resources in the country. PIGB aimed at encourage a conducive business environment for petroleum industry operations in the country and create effective governing institutions with separate roles for the petroleum industry.

The following are the effects of the petroleum industry governance bill.

(a) The Bill looks to establish the Nigerian Petroleum Regulatory Commission (NPRC), a single regulator to serve as the supervisory body for the oil and gas industry. It will replace the Department of Petroleum Resources (DPR), the Petroleum Products Pricing Regulatory Agency (PPPRA) and the Petroleum Inspectorate. All of the functions of DPR, PPPRA and the petroleum inspectorate will be carried out by the NPRC.

(b) The Petroleum Industry Governance also split the NNPC (Nigerian National Petroleum Corporation) into smaller entities, to ensure efficiency and transparency. The NNPC will be replaced by the National Petroleum Company (NPC), and all of the nation's refineries and joint venture assets will be moved from the NNPC to the NPC.

(c) In the PIGB, some of the regulatory functions of the minister of petroleum resources will be transferred to NPRC. A nine-man board will govern the NPRC with a fixed tenure, and the board is going to have representatives from the ministries of petroleum resources.

28.5 Fiscal/operating arrangement in the upstream sector

28.5.1 Joint Venture (JV)

Joint venture is a contractual arrangement whereby two or more parties undertake an economic activity which is subject to contractually agreed basis of sharing control. Companies producing crude oil in Nigeria are not allowed to produce the oil solely on their own. Each company is required to enter into a Joint Venture Agreement with the Nigerian National Petroleum Corporation (NNPC) in respect of the company's operation in a particular oil field.

A detailed joint venture operating agreement will be entered into by the parties. The agreement will spell out in detail the rights and obligations of each party with respect to the particular venture.

NNPC will usually take up a majority of the venture while the oil producing company will take up the balance. One of the parties to the venture is given the responsibility to operate the venture, that is, the production of crude oil from the concession that is the subject of the venture. This is the operator. The operator is the party that conducts the operations under a joint venture. This may include the drilling of a well and/or the production of oil from a tract or field under an agreed contract. In all or most of the cases, in spite of NNPC majority shareholding, it is the oil producing company that is appointed as field operator of the joint venture.

Each party to the joint venture is expected to fund its equity share in the venture. This is done when the operator makes calls for the needed cash (cash calls). Each party also lifts crude oil, from the crude oil produced, in proportion to its equity interest in the joint venture. When NNPC is unable to lift all its share of the crude produced, the field operator, will under special arrangement with NNPC, lift the balance, sell it and pass the proceeds of sale to NNPC.

28.5.2 Production sharing contracts – deep offshore and inland basin

In Production sharing contracts (PSC), the petroleum producing companies enter into agreement with NNPC for the production of crude oil in particular oil fields respectively. The operating expenses for the petroleum operations would be met by each operator. This is a major shift from the terms in joint venture contracts. In case of joint venture, NNPC will fund the operational expenses of the venture in proportion to its share in the joint venture, but in respect of PSC's, the petroleum producing company will fund 100% of the contract. The provision for the reimbursement of costs to the operator in executing the contract will be contained in the PSC. This is usually achieved through the allocation to the operator of a proportion of the oil produced, from which the company is expected to recover its cost of producing the oil and of executing the contract generally.

Oil recovered in the contract area is split into:

(a) Royalty oil
(b) Cost oil
(c) Tax oil
(d) Profit oil.

Business activities under PSC are subject to tax under the Petroleum Profits Tax Act and the Deep Offshore and Inland Basin Production Sharing Contracts Act No 9 of 1999. The Decree requires that the tax computation is done by NNPC or concession holder who will also lift the "tax oil", sell same, and pay the petroleum profits tax to the Revenue.

This is slightly contradictory to the relevant provision of PPTA. PPTA provides for persons engaged in petroleum operations to prepare tax returns, submit same, and pay the PPT due. The responsibility for the payment of PPT is clearly stated in PPTA. It is less clear in the Deep Offshore and Inland Basin Production

Sharing Contract.

The key provisions of the Deep Offshore and Inland Basin Production Sharing Contracts Act 1999 are:

(a) That the Petroleum Profits applicable to the contract area shall be 50% flat rate of chargeable profits for the duration of the Production Sharing Contracts;

(b) That in respect of any qualifying capital expenditure incurred wholly, exclusively and necessarily for the purposes of the petroleum operations carried out under the terms of a Production Sharing Contract in the Deep Offshore or Inland Basin, there shall be due to the parties:

(i) In respect of Production Sharing Contracts executed prior to 1 July, 1998, an Investment Tax Credit at a flat rate of 50 per cent of the qualifying expenditure; and

(ii) In respect of Production Sharing Contracts executed after 1 July, 1998 there shall be due to such Parties an Investment Tax Allowance at a flat rate of 50 per cent.

(c) In both cases, royalty is payable as follows:

		Rate
(i)	on-shore production	20%
(ii)	offshore production up to 100meterswaterdepth	18½%
(iii)	offshore production between 100 to 200 meters water depth 162/3%	
(iv)	In areas from 201 to 500 metres water depth	12%
(v)	In areas from 501to800 metres water depth	8%
(vi)	In areas from 801 to 1,000 metres water depth	4%
(vii)	In areas in excess of 1,000 metres water depth	0%

(d) Computation and payment of estimated and final petroleum profits tax shall be made in US dollars on the basis of the US dollar returns filed;

(e) The Corporation or the Holder, as the case may be shall pay royalty, concession rentals and petroleum profits tax on behalf of itself and the Contractor out of the allocated royalty oil and tax oil;

(f) Separate tax receipts in the names of the Corporation or the Holder and the Contractor for the respective amounts of the petroleum profits tax paid on behalf of the Corporation or the Holder and Contractor shall be issued by the Federal Inland Revenue Service in accordance with the terms of the Production Sharing Contract; and

(g) The chargeable tax on petroleum operations in the contract area under the Production Sharing Contracts shall be split between the Corporation or the Holder and the Contractor in the same ratio as the split of profit oil as defined in the Production Sharing Contract between them.

28.5.3 Deep Offshore and Inland Basin production sharing contract (Amendment) Act, 2019

The amendment is in line with the provisions of Section 16 of the Deep Offshore and Inland Basin Production Sharing Contracts Act, Cap D3, Laws of the Federation of Nigeria, 2004 (DOIBPSCA or “the Act”) which requires the Federal Government of Nigeria (FGN) to review the provisions of the Act when the price of crude oil exceeds $20 per barrel in real terms, or within a fixed number of years (15 years from commencement of the Act and 5 years thereafter).

The Amendment Act introduces four key changes to the DOIBPSCA, as follows:

(i) Replacement of the royalty regime applicable to Deep Offshore and Inland Basin fields (substitution of Section 5 of the Act).The Amendment Act introduces a combined production and price-based royalty system to replace the existing production-based royalty system, which varies according to areas of operations.

The new royalty regime specifies a baseline royalty of 10% for crude oil and condensates produced in the deep offshore (greater than 200 meter water depth) and 7.5% for the Frontier and Inland Basin. In addition to the baseline royalty, a royalty based on the applicable price of crude oil, condensate and natural gas will apply, but only when the price exceeds $20 per barrel. The graduated royalty rates are shown below:

i. from $0 up to $20 per barrel 0%

ii. above $20 and up to US $60 2.5%

iii. above $60 and up to US $100 4.0%

iv. above $100 and up to US $150 8.0%

v. above $150 10.0%

The level of impact the new royalty regime would have on total Government take and total Contractor take under existing Production Sharing Contracts (PSCs) will depend on the current royalty rate applicable to the contract area, the applicable price and the volume of crude oil/condensate produced.

(ii) Deletion of Section 16 of the Act

The Section states that: “(1) The provisions of this Act shall be subject to review to ensure that if the price of crude oil at any time exceeds $20 per barrel, real terms, the share of the government of the Federation in the additional revenue shall be adjusted under the production sharing contracts to such extent that the production sharing contracts shall be economically beneficial to the government of the Federation. (2) Notwithstanding the provisions of Subsection (1) of this Section, the provisions of this Act shall be liable to review after a period of fifteen years from the date of commencement and every five years thereafter.” The above Section has been a subject of controversy, even resulting in a consent judgement delivered by the Supreme Court of Nigeria in the case instituted by the Attorney-Generals of Rivers, Bayelsa and Akwa Ibom States against the Attorney-General of the Federation, where the issue for determination was the interpretation of the provisions of Section 16 of the Act.

(iii) Introduction of new Section 16(A) This Section mandates the Minister of Petroleum Resources to cause the Nigerian National Petroleum Corporation (NNPC) to call for a review of the PSCs every eight (8) years. The DOIBPSCA defines the PSC as “any agreement or arrangements made between the Corporation or the holder and any other petroleum exploration and production company or companies for the purpose of exploration and production of oil in the Deep Offshore and Inland Basin". This means that there could be PSCs executed solely between oil companies without the NNPC's involvement.

(iv) Introduction of offence and penalty for noncompliance (Section 16(B)). The Amendment Act introduces a fine of at least ₦500 million for non-compliance with any obligation imposed by the provision of the Act, or imprisonment for a period not less than five years, or both, upon conviction by a competent court of law.

28.5.4 Risk service agreement

There is no special arrangement between the operator and the government other than the granting of lease licence (OML,OPL). The operator bears all the risks, pay royalty on production and petroleum profit tax on its profit.

28.5.5 Oil and gas arrangement

Nigeria currently operates two contract arrangement to aid funding and exploration of oil and gas projects. These are: Joint Ventures (JV) under Joint Operating Agreements (JOAs) between international oil companies (IOCs) and NNPC, with NNPC representing the interest of the Nigerian government; and production sharing contracts (PSC) with IOCs.

28.5.6 Marginal field operators

Marginal Fields are field discovered usually by large international oil companies but which as a result of focus on larger and more profitable fields were not developed and yet not relinquished. These are however of interest to small players and therefore represent investment potential for small companies with workable operations. Such fields hold an aggregate estimated 2 billion barrels in reserve.

In its publication, the Department of Petroleum Resources mentioned that the Federal Government is favourably disposed to joint application and has set up a committee comprising the representative of DPR, leaseholders, and financial advisers to assess submission with the aim of identifying the company most likely to be successful in operating the marginal fields as well as further develop the Nigerian oil industry companies that are prequalified. The conditions are:

(iv) At least 51% of the beneficial interest of the company must be owned by Nigerian citizens;

(v) No single shareholder may own more than 25% of the shares in the company;

(vi) The company must have upstream oil and gas experience; and

(vii) The companies Memorandum and Articles of Incorporation must authorise the company to conduct oil and gas exploration and production activities.

(viii) Foreign companies may participate in the process by either incorporating a Nigerian branch with the Corporate Affairs Commission

- Participation by indigenous operators who bear all the risks and take all the crude produced

- Lack of incentives compared to Joint Venture and Production Sharing Contracts

- Many operators unable to produce up to the commercial quantity of at least 10,000 barrels per day

- Being capital intensive, where there is no discovery of oil, it would be difficult to write off the production expenses without any income

- Most operators are unable to get equity finance

- Some operators go into technical partnership so as to meet capital requirement under this arrangement, the technical partner recoups its costs with cost oil, pays Royalty and tax oil and share what is left.

- Tax rate of 85% is a burden

- Tax rate at 65.75% during the period of recouping the pre- production expenses

- Technical partners eager to recoup cost hence dubious clauses are inserted into the agreement leaving almost nothing for local partners

28.5.3 Upstream activities:

These activities are related to the acquisition of licences, exploration, development and production of crude oil and gas; treatment of oil and processing of gas as well as transportation and delivery to export terminals refineries or other processing plants.

These activities are taxed under the Petroleum Profits Tax, Act Cap P13 LFN 2004. This Act was first enacted in 1959; with retrospective effective date of 1 January 1958.

28.5.4 Downstream activities:

As defined by Nigerian Accounting Standard Board (Now Financial Reporting Council) they are those activities that take place from receipt of crude oil into crude oil tanks or gas into petro chemical tanks to the transportation of refined products to the final user or of processed products to secondary industries.

These activities encompass transporting, refining, liquefaction of natural gas, distributing and marketing of refined petroleum products, gas and derivatives. Companies engaged in downstream operations are subject to tax under the Companies Income Tax Act Cap C21 LFN 2004. These include marketing companies, independent marketers and servicing companies.

28.6 Definitions of terms as given in PPTA

All terms relate to companies engaged in petroleum operations.

28.6.1.1 Accounting period

(a) This is a period of one year commencing on 1st January and ending on 31st December of the same year; or
(b) Any shorter period commencing on the day the company first makes a sale or bulk disposal of chargeable oil under a programme of continuous production and sales, domestic, export or both, and ending on 31 December of the same year; or
(c) Any period of less than a year being a period commencing on 1 January of any year and ending on the date in the same year, when the company ceases to be engaged in petroleum operations.

28.6.2 Revenue service

The Federal Inland Revenue Service (FIRS).

28.8.3 Casing head petroleum spirit

Any liquid hydrocarbons obtained in Nigeria from natural gas by separation or by any chemical or physical process but before the same has been refined or otherwise treated. Casing head petroleum spirit is further subdivided into two, namely:

28.8.4 Chargeable natural gas

Natural gas actually delivered by a company to the Nigerian National Petroleum Corporation under a Gas Sales contract but does not include natural gas taken by or on behalf of the Government of the Federation;

28.8.5 Chargeable oil

Casing head petroleum spirit and crude oil won or obtained by a company from petroleum operations.

28.9 Definitions

28.9.1 Company

Anybody corporate incorporated under any law in force in Nigeria or elsewhere.

28.9.2 Crude oil

Any oil (other than oil extracted by destructive distillation from coal, bituminous shales, or other stratified deposits) won in Nigeria, either in its natural state or after the extraction of water, sand or other foreign substance there from but before any such oil is refined or otherwise treated.

28.9.3 Disposal or disposed of

In relation to chargeable oil owned by a company, disposal or disposed of connotes respectively:

(a) Delivery, without sale, of chargeable oil to; and
(b) Chargeable oil delivered, without sale to, a refinery or to an adjacent storage tank for refining by the company.

28.9.4 G-Factor

Gas production cost adjustment factor.

28.9.5 High court

The High Court in Nigeria within whose jurisdiction is the place:

(a) In relation to any offence under the PPT Act, where such offences deemed to have occurred;

(b) In relation to any suit for tax or appeal against an assessment of tax, where the tax return has been submitted or where the assessment of the tax was made as the case maybe;

(c) In relation to where the Revenue Service directs a company to keep proper books of accounts, in accordance with the relevant provisions of the Act, from where the direction was issued; and

(d) In relation to any claim or other matter which is subject to appeal in like manner as an assessment, where the claim or other matter was refused by the Revenue Service.

28.9.6 Intangible drilling costs

All expenditure for labour, fuel, repairs, maintenance, hauling, and supplies and materials (not being supplies and materials for well cement, casing or other well fixtures) which are for or incidental to drilling, cleaning, deepening or completing wells or the preparation thereof incurred in respect of:

(a) Determination of well locations, geological studies and topographical and geophysical surveys preparatory to drilling;

(b) Drilling, shooting, testing and cleaning wells;

(c) Cleaning, draining and leveling land, road-building and the laying of foundations;

(d) Erection of rigs and tankage assembly and installation of pipelines and other plant and equipment required in the preparation of drilling of wells producing petroleum.

28.9.7 Liquefied natural gas

Natural gas in its liquid state at approximately atmospheric pressure

28.9.8 Minister

Minister charged with responsibility for matters relating to taxes on incomes and profits.

28.9.9 MMcf

One million cubic feet

28.9.10 Natural gas

Gas obtained in Nigeria from bore holes and wells consisting primarily of hydrocarbons.

28.9.11 Non-productive rents

The amount of any rent for which there is provision for its deduction from the amount of any royalties under an oil prospecting licence or oil mining lease, to the extent that such rent is not so deducted.

28.9.12 Oil mining lease (OML)

Alease granted to a company under the Minerals Act, for the purpose of winning petroleum, or any assignment of such lease.

28.9.13 Oil prospecting licence (OPL)

A licence granted to a company under the Minerals Act, for the purpose of winning petroleum, or any assignment of such licence.

28.9.14 Person

This includes a company and any unincorporated body of persons.

28.9.15 Petroleum

Any mineral oil or relative hydrocarbon and natural gas existing in its natural condition in Nigeria, but does not include liquefied natural gas, coal, bituminous shales or other stratified deposits from which oil can be extracted by destructive distillation.

28.9.16 Petroleum operations

The winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in the course of a business carried on by the company engaged in such operations, and all operations incidental thereto and any sale of or any disposal of chargeable oil by or on behalf of the company.

28.9.17 Resident in Nigeria

In relation to a company, this means a company, the control and management of the business of which are exercised in Nigeria.

28.9.18 Royalties

(a) The amount of any rent for which there is provision for its deduction from the amount of any royalties under an oil prospecting licence or oil mining lease to the extent that such rent is so deducted; and

(b) The amount of any royalties payable under any such licence or lease less any such rent deducted from those royalties.

28.9.19 Concession

This includes an oil exploration licence, an oil prospecting licence, an oil mining lease, any right, title or interest in or to petroleum oil in the ground and any option of acquiring any such right, title or interest;

28.9.20 Lease

This includes an agreement for a lease where the term to be covered by the lease has begun, any tenancy and any agreement for the letting or hiring out of an asset, but does not include a mortgage, and all cognate expressions including "leasehold interest" shall be construed accordingly.

28.9.21 Administration of Petroleum Profits Tax Act

The administration of the Petroleum Profits Tax Act is under the charge and management of the Federal Inland Revenue Service. The Revenue Service may do all acts as may be deemed necessary and expedient for the assessment and collection of the tax and shall account for all amounts so collected in a manner to be prescribed to the Federal Minister of Finance through its Revenue Service.

Whenever the FIRS consider it necessary with respect to any tax due, it may acquire, hold and dispose of any property taken as security for or in satisfaction of any tax or of any judgment debt due in respect of any tax and shall account for any such property and the proceeds of sale thereof in a manner to be prescribed by the Minister (Section 3(b)).The Revenue Service may sue and be sued in its official name (Section 3(c)).

28.9.22 Delegation

Subject to such conditions as the Revenue Service may specify, the Revenue Service may by notice in the Federal Gazette direct that any information return or documents required to be supplied, forwarded or given to the Revenue Service may be supplied to such other person whether within or without Nigeria as the Revenue Service may direct. The Revenue Service may by notice in the Federal Gazette or in writing authorize any person within or without Nigeria to:

(a) perform or exercise, on behalf of the Revenue Service, any power or duty conferred upon the Revenue Service other than the powers or duties specified in the First Schedule: and

(b) receive any notice or other document to be given, delivered or served upon the Revenue Service under or in consequence of the Act or any subsidiary legislation made there under (Section3(e)).

The powers or duties specified in the first schedule that cannot be delegated by the Revenue Service are:

- Section 32(2), Revenue Service to call for returns;
- Section 33(1),returns of estimated tax;
- Section 37(1), making of assessments.

(a) Powers and duties of the FIRS should be as stipulated in the PPTA Act, Section 3(b) With respect to any tax due;

(b) The Revenue Service may acquire, hold and dispose of any property taken as security for or in satisfaction of any tax or of any judgment debt due in respect of any tax and shall account for any such property and the proceeds of sale thereof;

(c) Section 3(d) The Revenue Service may by notice in the Federal Gazette direct that any information, return or documents required to be supplied forwarded or given to the Revenue Service may be supplied to such other person as the Revenue Service may direct;

(d) Section 6(2) The Revenue Service may, from time to time, specify the form of returns, claims statements and notices under the Act;

(e) Section 15 The Revenue Service powers under the artificial transaction provisions;

(f) Section 31 The Revenue Service power to call for further information;

(g) Section 37 The Revenue Service power to make assessments;

(h) Section 49 The Revenue Service power to grant relief for error or mistake;

(i) Section 52 The Revenue Service power to levy penalty for making incorrect accounts;

(j) Section 53 The Revenue Service power to levy a fine in respect of false statements and returns; and

(k) Section 58 The power of the Revenue Service to commence prosecution in respect of an offence.

28.9.23 Control by the Minister

In the exercise of the powers and duties conferred upon it, the Revenue Service shall be subject to the authority, direction, and control of the Federal Minister of Finance. Any written direction, order or instruction given by the Minister after consultation with the Chairman of the Revenue Service shall be carried out by the Revenue Service.

However, the Minister shall not give any such direction etc. in respect of any particular company which would have the effect of requiring the Revenue Service to increase or decrease any assessment made or to be imposed upon or any relief given or to be given to or defer the collection of any tax, penalty or judgement debt due by such company or which would have the effect of altering the normal course of any proceedings, whether civil or criminal, relating either to the recovery of any tax or penalty or to an offence relating to the tax. Any act, matter or thing done by or with the authority of the Revenue Service in pursuance of the provisions of PPTA shall not be subject to challenge on the ground that such was not or was not proved to be in accordance with any direction, order or instruction given by the Minister.

28.9.24 Signification and execution of powers, etc.: Section 4

(a) Anything required to be done by the Revenue Service, in relation to the powers or duties specified in the first schedule to the Act, may be signified under the hand of the Chairman of the Revenue Service Board, or of an officer of the Federal Inland Revenue Service Board who has been authorised by the Revenue Service to signify from time to time, anything done or to be done by the Revenue Service in respect of such powers or duties.

(b) Any authorisation given by the Revenue Service Board under or by virtue of the Act shall be signified under the hand of the Chairman of the Revenue Service Board unless such authority is notified in the Federal Gazette.

(c) Subject to subsection (1) of this Section, any notice or other document to be given under the Act shall be valid if:

(i) It is signed by the Chairman of the Revenue Service Board or by any person authorised by him; or

(ii) Such notice or document is printed and the official name of the Revenue Service Board is duly printed or stamped thereon.

(d) Every notice, authorisation or other document purporting to be a notice, authorisation or other document duly given and signified, notified or bearing the official name of the Revenue Service, in accordance with the provisions of this Section, shall be deemed to be so given and signified, notified or otherwise without further proof, until the contrary is shown.

28.10 Duty of confidentiality (section 5)

Every person having possession of or control over any documents, information, returns or assessment lists or copies of such lists relating to tax or petroleum operations or the amount and value of chargeable oil won by any company who at any time communicates or attempts to communicate such information or anything contained in such documents, returns, lists, or copies to any person:

(a) Other than a person to whom he is authorised by the Minister to communicate it; or

(b) Otherwise than for the purpose of the Act or of any Act or law, relating to a tax upon income, in force in any part of Nigeria; shall be guilty of an offence.

No person appointed or employed to carry out the provision of the Acts shall be required to produce in any court any return, document or assessment, or to divulge or communicate to any court any matter or thing coming under his notice in the performance of his duties under the Act except as may be necessary for the purpose of carrying into effect the provisions of the Act, or in order to institute a prosecution, or in the course of a prosecution for any offence committed in relation to tax.

The obligation as to secrecy shall not prevent the disclosure of necessary information to the authorised officers of the Government of such other country as might be necessary for double taxation relief purposes.

The Auditor-General of the Federation or any other officer authorised by him may not be prevented from having access to such records or documents as may be necessary for the performance of his official duties. The Auditor-General or any such official shall be deemed to be a person employed in carrying out the provisions of the Act for the purposes of secrecy.

28.11 Service of notice (Section 7)

Any notice to be served in pursuance of the provisions of the Act can be served either personally or by registered post. Where a notice is sent by registered post, it shall be deemed to have been served on the day succeeding the day on which the addressee of the registered letter containing the notice would have been informed in the ordinary course of events that such registered letter is awaiting him at a post office.

Provided that a notice shall not be deemed to have been served if the addressee proves that, no notification, informing him of the fact that the registered letter is awaiting him at a Post Office, was left at the address given on such registered letter.

A notice to be served shall be addressed:

(a) In the case of a company incorporated in Nigeria, to the registered office of the company; and

(b) In the case of a company incorporated outside Nigeria either to the individual authorised to accept service of process under the Companies and Allied Matters Act at the address filed with the Registrar-General, or to the registered office of the company wherever it may be situated.

Where service of any notice has proved impossible, the notice may be served by being left at the appropriate office or address as determined above, unless such address is a registered post office box number.

28.12 Nature and classification of income

The oil and gas industry is characterized by certain factors that are peculiar to the industry. One of these is the time lag (could be several years) between the time that an investment is made for exploratory activities and the time that the oil can be produced in commercial quantity and sold to generate income. There is the high risk and uncertainty of the results that will be obtained from exploration activities.

The only conclusive evidence of the availability of oil in any location can only be obtained by drilling. The risk is very high of not finding recoverable oil reserves or not finding such in commercial quantity.

Statistics have it that on the average, oil will be found in commercial quantity in one out of forty exploratory wells. Other risks that are present in the oil and gas industry are: market risk; sovereign/political risk; partner risk; and taxation risk. All these would impact greatly on the investments and return on investments in the industry.

The very high returns in the industry are to compensate for the very high risks. The industry deals in high volume of production with all the advantages of economies of scale. Financial returns are usually substantial whenever there are large finds. Profitability can also be very high in periods of high oil prices as the situation was in the 3rd quarter of 2008 when oil price reached an all-time high of $145 per barrel.

The main sources of income of a petroleum producing company are:

(a) Sale of crude oil: Export and Local (Equity share);

(b) Sale of gas: Export and Local (Equity share);and

(c) Income from lifting and sale of NNPC equity crude.

Other items of income, for example, interest income, would be earned from activities that are considered to be incidental to petroleum operations. Incidental income will be subject to Petroleum Profits Tax.

Some of the income that could be treated as incidental income are:

(a) Ullage fees;

(b) Rentals;

(c) Management fees;

(d) Mineral property conveyance; and

(e) Interest on fixed deposits.

Balancing charge on disposal of items of qualifying expenditure is also to be treated as incidental income in the computation of Petroleum Profits Tax. (Gains or losses on their disposal are excluded from the Petroleum Profits Tax computations).

Another point worthy of note in the determination of income in the oil and gas industry, is that oil produced is deemed sold when produced. As a result of this the sales value of crude oil produced can be taken to income immediately without waiting until the time of actual sales.

28.13 Nature of costs

The relevant part in PPTA is Section 9. The comparable condition stated in this Section for the allow ability of expenses for tax purposes is that such must be incurred for the purpose of its petroleum operations. Note that there was no specification that it must be incurred "in the production of the income or profits."

The nature of petroleum operations business necessarily requires that certain expenses have to be incurred for the business that could not be tied directly to the income produced. It is clear that such would have been incurred for the petroleum operations albeit have not produced income/profits. The fact that they have not produced income is recognised in PPTA as insufficient ground to disallow them in PPT computations. The expense headings in this category are:

(a) Outgoings on unproductive leases (Section 10 deductible or if capitalised, capital allowances will be claimed in accordance with the provisions of the Second Schedule);

(b) Non-productive rents – Section 10 deductible;

(c) Tangible costs directly incurred in connection with drilling and appraisal of development well. (Section 10 deductible or capital allowances granted in accordance with the provisions of the Second Schedule);

(d) Exploration and drilling costs, including costs relating to the drilling of the first two appraisal wells in a particular field. (Section 10 deductible or capital allowance granted in accordance with the provisions of the Second Schedule);

(e) All sums by way of duty, customs and excise duties, stamp duties, education tax, (amendment in Act No. 18 of 1998 included education tax with effect from 1/1/96), tax (other than PPT) or any other rate, fee or other like charges Section 10deductible;

(f) All sums by way of customs or excise duty or other-like charges levied in respect of machinery, equipment and other goods used in the company's petroleum operations. Section 10 deductible; and

(g) All sums incurred by way of interest on any inter-company loans obtained under terms prevailing in the open market, that is, the London Inter-Bank Offer Rate. Section 10 deductible.

28.14 Classification of costs

The following are the classifications of costs in the upstream sector of the petroleum producing industry:

(a) Mineral rights acquisition costs;

(b) Exploration and drilling costs;

(c) Development costs;

(d) Production costs;

(e) Support equipment and facilities costs;

(f) General costs.

28.14.1 Mineral rights acquisition costs

Mineral rights acquisition costs are incurred in acquiring concession rights in a lease area. They include signature bonus (initial consideration paid by the lessee to the lessor), legal fees, local statutory land acquisition fees/levies, reserves value fees, etc. Acquisition costs may relate to proved or unproved properties. Costs incurred to purchase, lease, or otherwise acquire an item (whether proved or unproved) are initially capitalized when incurred. They include the costs of:

- Oil Prospecting Licence (OPL); (to search for oil)
- Oil Exploration Licence (OEL); (to explore for petroleum)
- Oil Mining Lease (OML); (to win, work, carry away and dispose of petroleum)
- Bonuses and options to purchase or lease properties;

- Minerals, when land including mineral rights purchased; and
- Recording fees, legal and other costs incurred in acquiring properties.

Pre-licence costs are those incurred in the period, prior to the acquisition of a legal right to explore for oil and gas in a particular location. Such costs include those incurred on the acquisition of speculative seismic data and expenditure on the subsequent geological and geophysical analysis of the data.

28.14.2 Exploration and drilling costs

Exploration and appraisal costs are incurred in the search for oil and gas deposits after obtaining a licence, but before a decision is taken to develop a reservoir.

Exploration and drilling involve:

(a) Identifying areas that may warrant evaluation; and

(b) Evaluating specific areas that are considered to have petroleum prospects largely through the drilling of exploratory wells.

Exploration costs may be incurred both before obtaining concessions (sometimes, referred to in part as pre-licence costs) and after acquiring concession.

Principal types of exploration costs, which include depreciation and applicable operating costs of support equipment and facilities and other costs of exploration activities, are:

(a) Costs of geological and geophysical studies, rights of access to properties to conduct those studies, and salaries and other expenses of geologists, geophysical crews, and others conducting those studies;

(b) Costs of carrying and retaining undeveloped properties, such as rentals, legal costs for title deeds, stamp duties, and the maintenance of lease records;

(c) Dry hole contributions and bottom hole contributions;

(d) Costs of drilling and equipping exploratory wells; and

(e) Other associated costs such as re-settlement of local communities, compensation for economic crops, surface rights and road building.

Exploration costs include appraisal costs which are incurred, to determine the size and characteristics of a reservoir discovered, in order to assess its commercial potentials. The costs of drilling exploratory wells are usually capitalised as part of the company's uncompleted wells, equipment and facilities pending determination of whether the well has proved reserves. If the well has proved reserves, the capitalised costs of drilling the well become part of the company's wells and related equipment and facilities (though the well may not be completed as a producing well). On the other hand, if the well is dry, the treatment will depend on the accounting method adopted by the company (that is full costs or successful efforts method).

An exploratory well may have found oil and gas reserves, but classification of those reserves as proved reserves cannot be made until drilling is completed. On completion of drilling, classification of the reserves depends on whether a major capital expenditure can be justified, which in turn, depends on whether additional appraisal wells confirm sufficient quantities of reserves. This situation arises principally with exploratory wells drilled in remote areas for which production would require construction of a network of pipelines and/or production facilities.

In such a case, the cost of drilling the exploratory well is usually carried as an asset provided sufficient quantity of reserve to justify its completion as a producing well exists and the drilling of additional wells has been firmly planned for the near future. Otherwise, the exploratory well is considered impaired and the exploratory well costs written off if the company adopts successful efforts method of accounting. It is not unusual for oil companies to carry wells in progress for more than two years before a decision is taken to capitalise or expense costs of exploration or appraisal activities.

28.14.3 Development costs

Development costs are incurred to obtain access to proved reserves and provide facilities for extracting, gathering, treating, and storing the oil and gas. These costs are incurred after a decision has been taken to develop a field or reservoir, and include the following:

(a) Drilling, equipping and testing development and production wells;

(b) Production platforms, down hole and wellhead equipment, pipelines, production and initial treatment and storage facilities as well as utility and waste disposal systems; and

(c) Improved recovery systems and equipment

Development costs are usually capitalised as part of the costs of a company's wells and related equipment and facilities. Thus, all costs incurred to drill and equip development wells and service wells are development costs and are capitalised whether the well is successful or unsuccessful. Costs of drilling those wells and costs of constructing equipment and facilities are usually included in the company's uncompleted wells, equipment and facilities until drilling or construction is completed.

28.14.4 Production costs

Production costs are the recurrent costs incurred in oil and gas production activities. Production involves lifting the oil and gas to the surface, gathering, treating, field processing and storage. Production costs are usually determined to be all costs incurred from the maintenance of the wells and well heads to the storage facilities when the oil and gas are ready for export or delivery to a refinery.

Production costs are those incurred to operate and maintain a company's wells and related equipment and facilities, including depreciation, depletion and applicable operating costs of support equipment and facilities. Examples of production costs are:

(a) Costs of personnel engaged in the operation of wells and related equipment and facilities;
(b) Repairs and maintenance of production facilities;

(c) Materials, supplies, fuel consumed and services utilised in such operations; and

(d) Royalties.

28.14.5 Support equipment and facilities costs

Costs incurred on support equipment and facilities in oil and gas producing activities, such as vehicles, repair shops, warehouses, supply points, camps, and divisional, district or field offices, aircraft and helicopters, safety and environmental facilities are usually accumulated and reallocated to the classes of costs identified above on some rational basis. For example, use of vehicles may be reallocated on kilometres, use of power house on the basis of wattage reading, and so on.

28.14.6 General costs

Some costs incurred in a company's oil and gas producing activities do not always result in acquisition of an asset and therefore are usually charged to expense. Examples include geological and geophysical costs, the costs of carrying and retaining undeveloped properties, and the cost of drilling those exploratory wells that do not result in proved reserves.

The costs of a company's wells and related equipment and facilities and the costs of the related proved properties are usually amortised as the related oil and gas reserves are produced from the reserves. Depreciation, depletion, and amortisation of capitalised acquisition, exploration, and development costs also become part of the cost of oil and gas produced along with production (lifting) costs identified above.

Oil companies incur substantial costs in providing amenities for the communities where they operate. Such costs which do not have future benefits to the company are usually expensed. Oil companies also incur costs on such matters as corporate affairs, staff training and development.

28.15 Petroleum profit tax

Ascertainment of adjusted profits and imposition of tax for petroleum producing company

28.15.1 Imposition

Section 9 of the PPTA levies tax on the profits of each accounting period of any company engaged in petroleum operations. Particular note should be taken of the fact that the basis period for any assessment year isthe same as the accounting period of the company i.e. the assessment is on current/actual year basis. For example, assessment for the 2018 assessment year of a company that has been engaged in petroleum operations for several years will be based on the result of the accounting period of the company commencing from 1 January, 2018 and ending on 31 December, 2018.

28.15.2 The profits of an accounting period, S9 (i)

The profits of a company for an accounting period is computed as the aggregate of the following:

(a) The proceeds of sale of all chargeable oils old;

(b) The value of chargeable oil disposed of; and

(c) All income incidental to and arising from one or more of its petroleum operations.

The value of chargeable oil disposed off (Section 9 (2)).

This will arise where a company is in both the business of petroleum operations and the business of refinery, and the refinery is supplied with crude oil by the petroleum company.

The value of all chargeable oil disposed off" is the aggregate of:-

a) the value of that oil as determined, **for the purposes of royalty,** in accordance with the provisions of any enactment applicable thereto and any financial agreement or arrangement between the Federal Government of Nigeria and that company;
b) any cost of extraction of that oil;
c) any cost incurred by the company in transportation and storage of that oil between the field of production and the place of its disposal.

Value of crude oil for royalty purpose

This shall be computed as follows:

i) Ascertain the quantity of oil produced by the company - **Q**
ii) Reduce this quantity by:
    a) Losses through evaporation - **q1**
    b) Internal usages by the company - **q2**
    c) Any reform to formation - **q3**
iii) Multiply the reduced quantity by **the Adjusted Posted Price**. Therefore, the value of crude oil disposed is: **{Q - (q1 + q2 + q3)}** x adjusted posted price **(APP)**

28.16 Adjusted profit

The adjusted profit of an accounting period shall be the profits of that period after the deductions of allowable expenses.

28.16.1 Allowable deductions, (section 10(1) PPTA 1959

In computing the adjusted profit of any company for any accounting period from its petroleum operations there shall be deducted; all out- going and expenses wholly, exclusively and necessarily incurred, whether within or outside Nigeria, during that period by such company for the purpose of petroleum operations. These include:

(a) Rents incurred by the company for that period in respect of land or building occupied under an Oil Producing License or an Oil Mining Lease for the disturbance of surface rights or any other like disturbance;

(b) All non-productive rents, the liability for which was incurred by the company during the relevant accounting period;

(c) All royalties, the liability for which was incurred by the company during the relevant accounting period in respect of natural gas sold and actually delivered to the Nigeria National Petroleum Corporation, or sold to any other buyer or customers or disposed off in any other commercial manner;

(d) All royalties, the liability for which was incurred by the company during that period in respect of crude oil or casing head petroleum spirit won in Nigeria;

(e) All sums the liability for which was incurred by the company to the Federal Government of Nigeria during the relevant accounting period by way of customs and excise duty or other- like charges levied in respect of machineries, equipment and goods used in the company's petroleum operations;

(f) Sums incurred by way of interest upon any money borrowed by such company, where the Board is satisfied that the interest was payable on capital employed in carrying on its petroleum operations;

(g) Sums incurred by way of interest on any inter-company loans obtained under terms prevailing in the open market by companies that engage in crude oil production operations in the Nigeria oil industry;

(h) Any expenses incurred for repairs of premises, plant ,machinery, or fixtures employed for the purpose of carrying on petroleum operations or for renewal, repairs or alteration of any implements, utensils or articles so employed;

(i) Debts directly incurred to the company and proved to the satisfaction of the Board to have become bad and doubtful in the accounting period for which the adjusted profits is being ascertained notwithstanding that such bad or doubtful debts were due and payable prior to the commencement of that period. Conditions for allowing bad and doubtful debt:

   (i) The deduction to be made in respect of a doubtful debt shall not exceed that portion of the debt which is proved to have become doubtful during that accounting period.
   (ii) It should be proved to the satisfaction of the Board that the debts in respect of which a deduction is claimed were either:

   (a) Included as a profit from the carrying on of petroleum operations in the accounting period in which they were incurred; or

   (b) Advances made in the normal course of carrying on of petroleum operations, strictly as defined under the PPTA and included in the definitions of profits of Petroleum Company as earlier defined.

(j) any other expenditure, including tangible costs directly incurred in connection with drilling and appraisal of development well but excluding expenditure which is qualifying expenditure for the purpose of the Second Schedule to the Act [Capital allowance].and

   i. Any expenditure directly incurred in connection with exploration drilling and the drilling of the first two appraisal wells in a particular field, including expenditure in respect of cement and casing of well fixtures.

   ii. Where a deduction may be given under this section in respect of any such expenditure, that expenditure shall not be treated as qualifying drilling expenditure for the purpose of capital allowance;

(k) Any contribution to a pension, provident, or other society, scheme or fund which may be approved, with or without retrospective effect, by the Board subject to such general conditions or particular conditions in the case of any such society; scheme or fund as the Board may prescribe;

(l) All sums, the liability of which was incurred by the company during that period to the Federal Government, or to any State or Local Government Council in Nigeria by way of duty, customs and excise duties, stamp duties, education tax, (other than the tax imposed by the PPTA);

(m) Such other deductions as may be prescribed by any rule made under the PPTA. Bad debt and other expenses recovered

Note: Where a deduction has been allowed to a company under this section in respect of any liability of the company and such liability or any part thereof is waived or released, the amount of the deduction or the part thereof corresponding to such part of the liability shall, for the purpose of subsection (l) (d) (taxable profits) of section 9 of the PPTA, be treated as income of the company of its accounting period in which such waiver or release was made or given.; and

With effect from 1st January 1999 interests on inter-company loans are allow able deductions

28.16.2 Non allow able deductions;

Subject to the express provisions of this Act, for the purpose of ascertaining the adjusted profit of any company of any accounting period from its petroleum operations, no deduction shall be allowed in respect of:

(a) any disbursement or expenses not being money wholly and exclusively paid out or expended, or any liability not being a liability wholly or exclusively incurred, for the purposes of petroleum operations;

(b) any capital withdrawn or any sum employed or intended to be employed as capital;

(c) any capital employed in improvement as distinct from repairs e.g. overhauling or refurbishing of assets;

(d) any sum recoverable under an insurance or contract of indemnity;

(e) rent of or cost of repair to any premises or part of any premises not incurred for the purpose of petroleum operations;

(f) any amounts incurred in respect of any income tax, profits tax, or other similar tax whether charged within Nigeria or outside Nigeria;

(g) the depreciation of any premises, buildings, structures, works of permanent nature, plant, machinery or fixtures;

(h) any payment to any provident, savings, widows and orphans, or other society, scheme or fund not approved by the Board;

(i) any customs duty on goods (including articles or any other thing) imported by the company:

   (a) for resale or for personal consumption of employees of the company; or

   (b) where goods of the same quality to those so imported are produced in Nigeria and are available, at the time the imported goods were ordered by the company for sale to the public at prices less or equivalent to the cost to the company of the imported goods;

(j) any expenditure for the purchase of information relating to the existence and extent of petroleum deposits; and

(k) Donations.

As contained in schedule 5 to CITA 1979 as amended to date, and the PITA, there is no provision in PPTA, relating to allowable donations. It is therefore technically correct that any donation made by any company engaged in petroleum operations is not an allowable deduction for the purpose of computing the petroleum profits tax.

28.17 Assessable profit/ loss relief (Section 14 (1))

The assessable profit of any company for any accounting period shall be the amount of the adjusted profit of that period after deduction of the amount of any loss incurred by that company during any previous accounting period 'and after adjusting for education tax (tertiary education tax).

Treatment of losses in petroleum profits tax computations:

Loss relief (Section 16)

To arrive at the assessable profits, there shall be deducted from the adjusted profits:

(a) The amount of any loss incurred by the company during the previous accounting period; and

(b) For a new company, the amount of any loss incurred during its first accounting period in its trade or business.

Losses that cannot be fully deducted in any one period can be carried forward to the next succeeding accounting periods until fully relieved. Furthermore, the company has the right to defer the utilization of any loss relief available to it. This is possible where within five months after the end of the accounting period, the company elects in writing not to deduct the amount of the loss or part thereof from the profits of the accounting period under consideration. The amount so deferred will be deducted from the following year's accounting profits unless the company makes a similar election in that following year.

28.18 Chargeable profit (Section 20)

The chargeable profits shall be the assessable profits, less capital allowances. For this purpose, the amount of capital allowances to be deducted is to be restricted to the lower of:

(a) the amount computed demonstrated below

		₦
Capital allowance b/f		xx
Plus:		
i.	Annual allowance for the year	xx
ii.	Petroleum investment allowance	xx
iii.	Investment tax credit, if applicable	xx
		xx

or;

(b) a sum equal to eighty-five percent of the assessable profits of the accounting period, less one hundred and seventy percent of the total amount of the deductions allowed as investment tax credit or petroleum investment allowance computed under the second schedule for that period. (Investment Tax Credit if the computation is for a company operating a Production Sharing Contract as provided in the Deep Offshore and Inland Basin Production Sharing Contract Decree 9 of 1999 and petroleum investment allowance in other cases.)

(c) This restriction is in order to ensure that the tax chargeable on the company is not less than fifteen percent of the tax that would have been chargeable had no deduction been made for capital allowances (Subsection 3 of Section 18).

Capital allowances that cannot be utilised due to this restriction are to be carried forward to be aggregated with the capital allowances computed for the following accounting periods and subjected to similar restriction in each of those accounting periods. From the foregoing, the relationship between the terms profits, adjusted profit, assessable profit and chargeable profit can be stated as follows:

Profits for the period	xx
Deduct: allowable expenditures (Section 10) (after necessary adjustment to eliminate transportation operations expenses included)	(x)
Deduct: Education Tax	(x)
Adjusted profit	xx
Less: loss relief (Section 14).	(x)
Assessable profit	xx
Deduct: capital allowances (as restricted) (Section 15).	(x)
Chargeable profit	xx

28.19 Qualifying expenditure/ capital allowance computation

Qualifying expenditure means capital expenditure incurred in an accounting period, which is:

(a) Incurred on plant, machinery or fixtures – "qualifying plant expenditure";

(b) Incurred on pipelines and storage tanks – "qualifying pipeline and storage expenditure";

(c) Incurred on the construction of buildings, structures or works of a permanent nature – "qualifying building expenditure";

(d) "Qualifying drilling expenditure" – incurred in:

- (i) The acquisition of, or rights in or over, petroleum deposits;
- (ii) Searching for or discovering and testing petroleum deposits, or winning access thereto; or
- (iii) The construction of any works or buildings which are likely to be of little or no value when the petroleum operations for which they were constructed ceased to be carried on.

Any sum that can be treated as an allowable expense in accordance with the provision of Section 10 of the Act cannot be treated as qualifying capital expenditure. Qualifying capital expenditure cannot be classified into more than one of the four headings above.

Where qualifying expenditure is incurred by a company before its first accounting period, such shall be deemed to be incurred by it on the first day of its accounting period.

Where the expenditure is incurred in respect of an asset which has been disposed of by the company before the beginning of its first accounting period, then any loss suffered by the company on the disposal of such asset shall be deemed to be qualifying drilling expenditure incurred by the company on that day, and be deemed to have brought into existence an asset owned by the company in use for the purposes of petroleum operations carried on by the company, and any profit realised by the company on such disposal shall be treated as income of the company of its first accounting period for the purposes of subsection (1)(a) of Section 9 of the Act.

28.19.1 Allowances

Conditions for granting capital allowances are as follows:

(i) The capital expenditure must be a qualifying expenditure;

(ii) The qualifying expenditure must be wholly, necessarily and exclusively used for the purposes of petroleum operations carried on by the company; and

(iii) The asset must be owned and used for petroleum operations at the end of the particular accounting period.

An asset is deemed to be in use during a period of temporary disuse.

Fixed assets acquired in an accounting period but put to use in a subsequent accounting period may qualify for capital allowances in the accounting period of purchase.

28.19.2 Annual allowance

This is granted annually on cost until the residue of the item is 1% of the original cost. The intent is that the amount of any qualifying expenditure is amortised over a period of five years in equal amount except the fifth year when 1% of the amount is retained. The rate is therefore 20% of the cost per annum for each of the first four years and 19% for the fifth year. The 1% of the cost of the asset must be retained in the books until the disposal of the item. This is represented below:

Year of use	AA%
1st Year	20%
2nd Year	20%
3rd Year	20%
4th Year	20%
5th Year	19%

Illustration

The following information were extracted from the account of Alagbara Oil Company Ltd for the year ended 31/12/2013 Assets brought forward:

Year		QCE Value ₦'000
2009	"	8,900
2010	"	7,600
2012	"	9,000
2013	"	5,400

Required: Calculate annual allowance for 2013 tax year.

Suggested solution to illustration:
Alagbara Oil Company Ltd. Calculation of annual allowance for 2013 tax year

Year	QCE ₦'000	Rate %	₦'000

2009	8,900	19	1,691
2010	7,600	20	1,520
2012	9,000	20	1,800
2013	5,400	20	1,080

Annual allowance on QCE = ₦6,091

28.19.3 Petroleum investment allowance

It is similar to investment allowance under CITA since it is not taken into account in arriving at the residue of an asset. It was termed Investment Tax Credit prior to the 1999 amendment. With the 1999 amendment, Investment Tax Credit is retained for companies that operate under the Deep Offshore and Inland Basin Production Sharing Contracts Act, 1999, while all others are entitled to Petroleum Investment Allowance. Petroleum Investment Allowance is granted in the accounting period in which the expenditure is incurred. It is granted only once for any particular asset. Petroleum Investment Allowance is made available at the appropriate rate per cent set forth in Table 1 to schedule 2 stated below:

Location of QCE	Rate Per Centum
Qualifying expenditure in Respect of On-shore operations	
Operations in territorial waters and continental shelf areas up to and including 100 metres of water depth	10
Operations in territorial waters and continental shelf areas in water depth between 100 metres and200metres	15
Operations in territorial waters and continental shelf areas beyond 200 metres of water depth	20

Computation of Petroleum Investment Allowance Illustration:
Dagunduro Petroleum Company incurred a QCE in 2012 accounting period up to ₦21m. Of this, on shore expenditure is ₦15m while off-shore expenditure is as stated below:

Up to and including 100m of water depth	₦3m
Between 100 and 200m of water depth	₦2m
Above 200m of water depth	₦1m

Required: Calculate;

(a) Annual allowance

(b) Petroleum investment allowance.

Suggested solution to illustration
Dagunduro Petroleum Company
Calculation of Annual Allowance

For 2012 tax year

(a) Annual allowance:	20% of₦21m	=	₦4.2m

(b) Petroleum Investment Allowance:	₦
On-shore at 5% (₦15m x 5/100)	750,000
Off-shore:	
- 100m of water depth at10%	300,000
- 100 - 200m of water depth at15%	300,000
- Above 200m of water depth at20%	200,000
Petroleum Investment Allowance	₦1, 550,000

28.19.4 Balancing allowances and balancing charges

The calculation of balancing allowance or charge follows normal taxation principles. The residue of qualifying expenditure is compared with the disposal proceeds to arrive at the balancing allowance or charge.

However, in petroleum Profits tax, balancing charge is to be treated as other income to form part of the profits of the company, while balancing allowances are aggregated with other capital allowances. Balancing allowance or charge shall also be made only if immediately prior to the disposal, the asset was in use for the purposes of petroleum operations for which the expenditure was incurred.

28.19.5 Residue of qualifying expenditure (paragraph 10 of second schedule)

The residue of qualifying expenditure, in respect of any asset, at any date, is the total qualifying expenditure incurred, less the total of annual allowances granted to that date in respect of the asset (paragraph 10 of the second schedule). It should be noted that the amount for Petroleum Investment Allowance is not to be deducted

Sale of buildings

Where capital expenditure has been incurred on the construction of a building, structure or works and thereafter the relevant interest therein is sold, the company which acquires that interest shall be deemed, except the granting of investment tax credit, to have incurred, on the date when the purchase price became payable, capital expenditure on the construction thereof equal to the price paid by it for such interest or to the original cost of construction, whichever is less:

Provided that:

(a) Where such relevant interest is sold before the building, structure or works has been used, the foregoing provisions of this paragraph shall have effect with respect to such sale with the omission of the words "except the granting of investment tax credit" and the original cost of construction shall be taken to be the amount of the purchase price on such sale; and

(b) Where any such relevant interest is sold more than once before the building, structure or works is used, the provisions of subparagraph (a) shall have effect only in relation to the last of those sales from qualifying expenditure in arriving at the residue.

Relevant interest

(a) The owner of a building, structure or works, shall be taken to be the owner of the relevant interest in such building, structure or works.

(b) The expression "the relevant interest" means, in relation to any expenditure incurred on the construction of a building, structure or works, the interest in such building, structure or works to which the company which incurred such expenditure was entitled when it incurred the expenditure.

(c) Where a company incurs qualifying building expenditure or qualifying drilling expenditure on the construction of a building, structure or works, the company is entitled to two or more interests therein, and one of those interests is an interest which is reversionary on all the others, that interest shall be the relevant interest for the purposes of the second schedule.

28.19.6 Meaning of "disposed of" (paragraph 11)

Subject to any express provision to the contrary, for the purposes of this schedule

(a) A building, structure or works of a permanent nature is disposed of if any of the following events occurs:

(i) The relevant interest is sold; or
(ii) That interest, being an interest depending on the duration of a concession, comes to an end on the coming to an end of that concession; or
(iii) That interest, being a leasehold interest, comes to an end otherwise than on the company entitled thereto acquiring the interest which is reversionary there on; or
(iv) The building, structure or works of a permanent nature are demolished or destroyed or, without being demolished or destroyed, cease altogether to be used for the purposes of petroleum operation carried on by the owner thereof;

(b) Plant, machinery or fixtures are disposed of, if they are sold, discarded or cease altogether to be used for the purposes of petroleum operations carried on by the owner thereof;

(c) Assets in respect of which qualifying drilling expenditure is incurred are disposed of, if they are sold or if they cease to be used for the purposes of the petroleum operations of the company incurring the expenditure either on such company ceasing to carry on all such operations or on such company receiving insurance or compensation monies therefore.

28.19.7 Value of an asset (paragraph 12)

(a) The value of an asset at the date of its disposal shall be:

(i) The net proceeds of the sale thereof or of the relevant interest there in; or

(ii) If it was disposed of without being sold, the amount which, in the opinion of the Revenue Service, such asset or the relevant interest therein, as the case may be, would have fetched if sold in the open market at that date, less the amount of any expenses which the owner might reasonably be expected to incur if the asset were so sold.

(b) For the purpose of this paragraph, if an asset is disposed of in such circumstances that insurance or compensation monies are received by the owner thereof, the asset or the relevant interest therein, as the case may be, shall be treated as having been sold and as though the net proceeds of the insurance or compensation monies were the net proceeds of the sale thereof.

(c) So much of subparagraph (1) as relates to the circumstances for determining the value of an asset by reference to the disposal of such asset other than by way of sale shall have effect:

(i) In relation to any asset or the relevant interest therein disposed of not being by way of bargain made at arm's length; or

(ii) Where the sale is between persons who are related to each other or between persons both of whom are controlled by some other person or one of whom has control over the other.

28.19.8 Apportionment (paragraph13)

(a) Any reference in this paragraph to the disposal, sale or purchase of any asset includes a reference to the disposal, sale or purchase of that asset, as the case may be, together with any other asset, whether or not qualifying expenditure has been incurred on such last-mentioned asset, and, where an asset is disposed of, sold, or purchased together with another asset, so much of the value of the assets as, on a just apportionment, is properly attributable to the first-mentioned asset shall, for the purposes of this schedule, be deemed to be the value of, or the price paid for, that asset, as the case may be. For the purposes of this subparagraph, all the assets which are purchased or disposed of in pursuance of one bargain shall be deemed to be purchased or disposed of together, notwithstanding that separate prices are or purported to be agreed for each of those assets or that they are or purported to be separate purchases or disposal of those assets.

(b) The provisions of subparagraph (1) of this paragraph, shall apply, with any necessary modifications, to the sale or purchase of the relevant interest in any asset together with any other asset or relevant interest in any other asset.

28.19.9 Part of an asset (paragraph14)

Any reference in this paragraph to any asset shall be construed whenever necessary as including a reference to a part of any asset (including an undivided part of that asset in the case of joint interests therein) and when so construed any necessary apportionment shall be made as may, in the opinion of the Revenue Service Board, be just and reasonable.

28.20.10 Extension of meaning of "In Use" (paragraph 15)

(a) For the purposes of this paragraph, an asset shall be deemed to be in use during a period of temporary disuse.

(b) For the purposes of paragraphs 5, 6 and 7 of the second schedule:

(i) An asset in respect of which qualifying expenditure has been incurred by the owner for the purposes of petroleum operations carried on by him shall be deemed to be in use for the purposes of such operations, between the dates hereinafter mentioned, where the Revenue Service is of the opinion that the first use to which the asset will be put by that owner incurring such expenditure will be for the purposes of such operations; and

(ii) The said dates shall be taken to be the date on which such expenditure was incurred and the date on which the asset is in fact first put to use:

Provided that where any allowances have been given in consequence of this subparagraph (2) of this paragraph and the first use to which such asset is put is not for the purposes of such operations, all such additional assessments shall be made as may be necessary to counteract the benefit obtained from the giving of any such allowances.

28.20.11 Exclusion of certain expenditure (paragraph16)

(a) Subject to the express provisions of this paragraph, where any company has incurred expenditure which is allowed to be deducted under any provision (other than a provision of this Schedule) of the Act, such expenditure shall not be or be treated as qualifying expenditure.

(b) Where any company has incurred expenditure upon any ocean- going oil-tanker plying between Nigeria and any other territory that expenditure shall not be treated as qualifying expenditure.

28.20.12 Assets used or expenditure incurred partly for the purpose of petroleum operations (paragraph 17)

(a) The following provisions of this paragraph shall apply where either or both of the following conditions apply with respect to any asset:

(i) The owner of the asset has incurred in respect thereof qualifying expenditure partly for the purposes of petroleum operations carried on by him and partly for other purposes; and

(ii) The asset in respect of which qualifying expenditure has been incurred by the owner thereof is used partly for the purposes of petroleum operations carried on by such owner and partly for other purposes.

(b) Any allowances which would be due or any balancing charges which would be treated as income if both such expenditure were incurred wholly and exclusively for the purposes of such petroleum operations and such asset were used wholly and exclusively for the purposes of such operations shall be computed in accordance with the provisions of this schedule.

(c) So much of the allowances and charges computed in accordance with the provisions of subparagraph (2) of this paragraph shall be due or shall be so treated, as the case may be, as in the opinion of the Revenue Service is just and reasonable having regard to all the circumstances and to the provisions of this schedule.

28.20.13 Disposal without change of ownership (paragraph18)

Where an asset in respect of which qualifying expenditure has been incurred by the owner thereof has been disposed of in such circumstances that such owner remains the owner thereof, then, for the purposes of determining whether and, if so, in what amount, any annual or balancing allowance or balancing charge shall be made to or on such owner in respect of his use of that asset after the date of such disposal:

(a) Qualifying expenditure incurred by such owner in respect of such asset prior to the date of such disposal shall be left out of account; but

(b) Such owner shall be deemed to have bought such asset immediately after such disposal for a price equal to the residue of such qualifying expenditure at the date of such disposal, increased by the amount of any balancing charge or decreased by the amount of any balancing allowance made as a result of such disposal.

Property, plant and equipment acquired under hire purchase

Fixed assets acquired under hire purchase agreements will qualify for capital allowances only to the extent of the amount of the installments paid during the accounting period.
The interest element of the installmental payments is also to be eliminated from the amount to be capitalized. This will be an allowable deduction as interest on money borrowed and used for the purposes of petroleum operations. This is the same treatment applicable to companies assessable to tax under the provisions of the Companies Income Tax Act.

28.21 Concepts and computations of posted prices and adjusted posted prices

28.21.1 Posted price (PP)

Posted price in relation to any crude oil exported from Nigeria by a company means the price free on board f.o.b. at the Nigerian port of export for crude oil of the gravity and quality in question which is from time to time established by the company, after agreement with the Government of Nigeria as to the procedure to be followed for the purpose as its posted price for Nigerian crude oil of that gravity and quality (Section 23(5).Every posted price established as aforesaid must bear a fair and reasonable relationship:

(a) To the established posted prices of Nigerian crude oils of comparable quality and gravity, if any; or

(b) If there are no such established posted prices for such Nigerian crude oils, to the posted prices at main international trading export centres for crude oil of comparable quality and gravity, due regard being had in either case to freight differentials and all other relevant factors.

The posted price for each type of crude oil stream is advised by the Organisation of Petroleum Exporting Countries (OPEC). With the information from OPEC, each member country sets the posted price, taking into account the sulphur content, freight differentials and other local factors.

The measurement unit for crude oil for posted prices purposes is “degrees API”. API (American Petroleum Institute) is a unit of specific gravity measurement approved by the American Petroleum Institute. Posted prices are quoted in the United States dollars per barrel at a specified API for each crude oil stream. For instance, if every degree of API above the standard API for the crude oil stream, the posted price is increased by $0.03 per barrel and every degree API below the standard, the posted price is decreased by $0.03 per barrel. Nigeria’s crude is of a maximum API of 400.

<u>Illustration</u>

If the posted price of a crude oil of 370 gravity is $31.70 and there is an adjustment of $1.15 for each degree fall in gravity below 370, if the actual gravity is 330, the posted price shall be adjusted to accommodate the short fall. The net result is the adjusted posted price as demonstrated below.

<u>Calculation of adjusted posted price (APP);</u>

	$
Posted price	31.70
Adjustment: 1.15(370 -330)	<u>(4.60)</u>
Adjusted posted price [APP]	27.10
	=====

28.22 Formats for computation of Petroleum profits tax

1] When the details of production and or sales are given [number of barrels sold locally/exported and the prices per barrel

Omodara petroleum limited

2008 Petroleum profits tax computation

Fiscal value of chargeable oil	₦’million
Export (Number of barrels x posted price)	xxx
Local sales: (Number of barrels x selling price)	xxx
Fiscal value of chargeable oil	<u>xxx</u>
Add: Other income incidental to petroleum operations	<u>xxx</u>
Profit of the accounting period	xxx
Less: Allowable deductions including education tax	<u>(xxx)</u>
Adjusted profit of the accounting period	xxx
Deduct: Unrelieved loss brought forward	<u>(xxx)</u>

Assess able profit	xxx
Less: capital allowances	
(Restricted to lower of actual allowances	
and 85% of assessable profit less 170%	
of petroleum investment allowance)	(xxx)
Charge able profit	xxx
Assessable tax at 85% of chargeable profit	xxx

Illustration

Gbogbonise Limited is engaged in petroleum business. You have been given the following information in respect of the Company for the year ended 31 December, 2015.

	Export	Local	
Crude oil in barrels	395,086	662,594	
		₦	₦
Applicable posted / Selling prices		57.065	0.27
Sundry income		681,301	122,999
Recurrent administrative and production expenses		2,146,125	448,490
Intangible development expenditure		669,684	121,650
Exploration and appraisal wells expenditure		1,432,061	260,129
Royalty on oil sold		4,671,812	38,291

Qualifying capital expenditure:

		₦
During	1/4/2005	1,266,890
During	2006	68,151
During	2013	65,468
During	2014	277,902
During	2015	608,050

The additions for 2015 are classified as:

(i) Operations in territorial waters and continental shelf areas up to and including 100 metres of water depth ₦ 208,050

(ii) Operations in territorial waters and continental shelf areas beyond 200 metres of water depth ₦400,000

Customs duties for the year ended:

31/12/2014	₦1,500
31/12/2015	₦1,710

The following additional information was also made available to you:

(i) Sundry income includes profit of ₦4,185 on disposal of assets for which appropriate approval has been obtained

(ii) Recurrent administrative and production expenses include donations of ₦5,864 to

Oil Palm Research You are required to:

(a) State the year of assessment

(b) For the stated year of assessment, calculate:

(i) Net fiscal value of chargeable oil

(ii) Total income

(iii) Assessable profit

(iv) Capital allowances

(v) Charge able profits

(vi) Chargeable tax Suggested

Solution to illustration

a) The year of assessment is 2015 i.e. Petroleum Profit taxis computed on Actual Year Basis (AYB).

b) Gbogbonise Limited Computation of charge able tax for 2015 year of assessment Income

		₦:	₦
	Export (395,086 x ₦57,065)		22,545,583
	Local; (662,594 x ₦0.27)		178,900
bi)	Net fiscal value of chargeable oil		22,724,483
	Sundry Income (wi)		800,115
bii)	Total income deduct:		23,524,598
	Recurrent, admin.& production		
	Expenses (wii)	2,588,751	
	Intangible development expenditure (wiii)	791,334	
	Royalty on oil sold (wiv)	4,710,103	
	Customs duties(2002)	1,710	
	Education tax (wv)	302,602	
	(8,394,500)		
	Adjusted profit		15,130,098
	Loss b/f		--- .
biii)	Assessable profit		15,130,098

biv) Capital allowances (wvi)	(291,089)
bv) Charge able profits	14,839,009
bvi) Chargeable Tax at 85%	₦12,613,158

Workings

1) Sundry income:

	₦
From export business	681,301
From Local business	122,999
Deduct:	
Profit on disposal of fixed asset	(4,185)
	800,115

2) Recurrent admin. & production expenses

		₦
Incurred on export business		2,146,125
Incurred on Local business		448,490
		2,594,61
Deduct;		
Donations to oil palm research	(5,864)	

3) Intangible development expenditure;

2,588,751

	₦
Incurred on export business	669,684
Incurred on Local business	121,650
	791,334

4) Royalty on oil sold

	₦
Incurred on export business	4,671,812
Incurred on Local business	38,291
	4,710,103

Education Tax

	₦
Total Income	23,524,598
Deduct;	
Recurrent, admin & prod. exp.	2,588,751
Intangible development exp.	791,334
Royalty on oil sold	4,710,103
Customs duties	1,710
	(8,091,898)
	15,432,700

Education tax 2/102 x15,432,700 = ₦302,602

5) Capital allowance ₦

(i) Capital allowance b/f

(ii) Annual allowance

Year	QCE	Rat	Allowance ₦
2005	1,266,890	-	-
2006	68,151	-	-
2013	65,468	20	13,094
2014	277,902	20	55,580
2015	608,050	20	121,610

--

Annual allowance			190,284

(iii) + Petroleum investment allowance

QCE ₦	Rate%	Allowance	
208,050	10	20,805	
400,000	20	80,000	100,805
Capital allowance for the year			291,089

Restricted to:	
85%of₦15,130,098	12,860,583
Deduct 170% of ₦100,805	(171,369)
Restricted amount	12,689,214
Therefore, Capital allowance claimed is	₦291,089

28.23 Tax offsets

28.23.1 Memorandum of understanding (MOU)

With effect from 1st January, 1986, the Federal Government of Nigeria entered into an agreement with the oil producing companies
(Memorandum of understanding MOU) granting certain incentives for the following objectives:

(a) Enhancing crude oil exports;

(b) Encouraging investments in exploration and development activities;

(c) Encouraging investments in the area of enhanced oil recovery projects

(d) Encouraging investments in gas utilization projects;

(e) Encouraging increased lifting and sale of NNPC's equity crude; and

(f) Effectively reducing the tax impact on companies engaging in petroleum operations.

MOU applies to petroleum companies operating joint ventures with NNPC.

The purpose of the incentive was to guarantee a \$2 per barrel profit margin (after tax and royalty) to the oil company at a notional technical cost of \$2 per barrel over the realisable price range of \$12.50 - \$23 per barrel. Provision was also made in the agreement for certain mechanism to be applied for establishing equitable margin to the oil company for realisable prices less than \$12.50/bbl.

Format for granting MOU	₦
Charge able profit	xx
Assessable tax@85%	xx
MOU	(xx)
Charge able tax	xx

Conditions under which the incentives can be granted and penalties for non-compliance:

The oil companies gave the following undertakings:

(a) To lift crude oil which NNPC is unable to lift out of the NNPC equity share of the joint venture production; and
(b) To carry out a work programme mutually agreed upon between NNPC and each of the oil companies.

When an oil company is unable to lift all or part of the notice volume, NNPC levies a penalty of 2% of the average realisable price for each barrel not lifted. Such penalty is not allowable as a deduction in the calculation of PPT. Where an oil company has not substantially complied with the specified work programme, a notice is served on the company. If within three months of the service of notice, the condition is not remedied, the incentives cease to apply and PPT is computed on pre- 1986 basis, until the non-compliance has been remedied.

28.23.2 Investment tax credit

Investment tax credit (with effect from 1999) [Sec.20 (1) PPTA]
A crude oil producing company which executed a Production Sharing Contract (PSC) with the Nigerian National Petroleum Corporation in 1993 shall, throughout the duration of the Production sharing contract claim investment tax credit allowance as an offset against tax in accordance with the provisions of the production sharing contract.

Applicable rate and basis of computation:

According to Sec. 20(2) of the PPTA the investment tax credit rate applicable to the contract area shall be 50% flat rate of chargeable profit for the duration of the production sharing contract. Tax payable when there is provision of Investment tax credit [Sec. 20 (3) PPTA]

In computing the tax payable [i.e. the chargeable tax], the investment tax credit shall be applicable in full to petroleum operations in the contract area such that the chargeable tax is the amount of the assessable tax less the investment tax credit.

Share of chargeable tax between the NNPC and the Oil producing company [S.20 (4)]

The chargeable tax computed under Sub.Sec.3 as stated above shall be split between the NNPC and the crude oil producing company in accordance with the proportion of the percentage profit oil split.

Format for computation of chargeable tax when there is psc agreement with NNPC in 1993

	₦	₦xx
Assessable Tax at 85% of chargeable profit)		
ITC; 50% of chargeable profit)		(xx)
Chargeable tax		xx
Share of chargeable tax;		
Nigeria National Petroleum Corporation		xx
NNPC (x %)		
Oil producing company (y%)	xx	xx
		==

(Note X% for NNPC and Y% for the crude oil producing company are in accordance with the proportion of the percentage of profit oil spilt).

28.24 Additional chargeable tax (section23)

In section 9 of the PPTA, the calculation of the profits of an accounting period is expected to be based on the actual proceeds of sale of crude oil export as made by the company. For instance, if the actual market selling price of one barrel of crude oil is $40 and a company exports its own crude at say $10 per barrel, on the basis of the provision of Section 9 of the PPTA, the company's accounting profit for that accounting year would be calculated on the basis of the $10 per barrel export sales proceeds plus the other sales. In such a situation, it is not likely that the accounts of the company would show a profit, super profits being made by its associates overseas to which the crude would have been sold at very low selling prices.

Section 23 was introduced partly for the purpose of discouraging such abuse and to ensure that sales of crude oil made by companies engaged in petroleum operations are made at prices that would align with the market prices.

The provision of Section 23 is to the following effect:

(a) Actual proceeds of sales of crude oil exported are computed, applying the actual selling prices. The resultant figure is used in the computation of the accounting profit and chargeable tax for the accounting period; and

(b) A sort of notional sales proceeds of crude oil exported (what the sales proceed could have been) is also computed, applying what is referred to as the posted prices in place of the actual selling prices by the company. The amount arrived at would also be used in the computation of the profits as well as the chargeable tax of the accounting period of the company.

The chargeable tax arrived at by applying the posted prices is compared with that arrived at by applying the actual export sales prices and the higher of the two shall be the final chargeable tax of the company for that accounting period. Thus, if the chargeable tax arrived at by applying the posted prices is higher, the company shall be liable to pay an additional amount of chargeable tax for that period equal to the difference between the two amounts.

The whole of any additional chargeable tax payable by a company by virtue of this provision for any accounting period shall be payable concurrently with the final installment of the chargeable tax payable for that period.

28.25 Artificial transactions (section15)

(a) Where the Revenue Service is of the opinion that:

(i) Any disposition is not in fact given effect to; or

(ii) That any transaction which reduces or would reduce the amount of any tax payable is artificial or fictitious, the Revenue Service may disregard any such disposition or direct that such adjustments shall be made as respects liability to tax as it considers appropriate.

The effect of the Revenue Service's decision will be to counteract the reduction of liability to tax effected, or reduction which would otherwise be effected, by the transaction. The company concerned shall be assessable accordingly. In this subsection, the expression "disposition" includes any trust, grant, covenant, agreement or arrangement.

(b) The following transactions shall be deemed to be artificial or fictitious, namely:

(i) Transactions between persons, one of whom has control over the other;

(ii) Or between persons, both of whom are controlled by some other person; which, in the opinion of the Revenue Service, have not been made on the terms which might fairly have been expected to have been made by independent persons engaged in the same or similar activities dealing with one another at arm's length. (Transactions that are not considered to have been carried out at arm's length shall be deemed to be artificial or fictitious).

(c) A company in respect of which any direction is made under this Section shall have a right of appeal in like manner as though such direction were an assessment.

28.26 Implication of Finance Act, 2019 on Provisions of PPT Act

Prior to implementation of Finance Act, 2019, dividends paid from petroleum profit are exempted from withholding tax deduction and not liable to any other forms of tax.

Finance Act, 2019 amended section 60 of PPT Act to the extent that dividends paid from petroleum profits are now subject to withholding tax deduction at the rate of 10%.

28.27 Tax regime applicable to sole risk and marginal field operators

The tax regime applicable to Sole Risk and Marginal Field operators are as follows:

(a) Tax registration: Companies are required to register for taxes and obtain a Tax Identification Number (TIN) soon after incorporation. This means that companies will no longer have to file separate applications to register for Income Tax and Value Added Tax.

(b) Companies' Income Tax ("CIT") returns should be filed during the pre- production period. The FIRS need companies to do this to enable it verify preproduction costs. The FIRS warned that they will contest the validity of preproduction costs that companies intend to capitalise upon production if such companies failed to file CIT returns during their pre-production period. The FIRS is of the view that Sole Risk and Marginal Field operators are not exempted from filing CIT returns with reference to section 55 of the CITA below:

"Every company, including a company granted exemption from incorporation, shall, at least once a year without notice or demand thereof, file a return with the Board in the prescribed form and containing prescribed information together with the following information ..."

In effect, such companies that have not started petroleum production would now have to file CIT returns during the exploration stage.

(c) Filing of CIT returns and compute PPT according to equity interest.

(d) Where companies engaged in petroleum operations can reasonably predict that they will commence crude production within an accounting period, the FIRS require such companies to file their Petroleum Profits Tax (PPT) estimated returns ahead of production.

For instance, if a company would commence production in August 2015, it is expected that it would file its estimated tax returns on or before the end of February 2015.

(e) Equity interest in an oil field shall be the only basis for reporting revenue and costs for PPT purposes in line with the provision of PPT Act

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(f) Seize to regard any joint filing of PPT returns by Joint Venture (JV) partners, if such partners have not obtained the requisite approval of the Minister of Petroleum Resources (MPR), as required by Section 23 of the PPT Act.

(g) Companies in petroleum operations may only complete and file PPT returns on the basis of the FIRS PPT returns schedules obtainable from appropriate FIRS offices.

(h) Separate CIT returns are to be filed for profits earned from outside petroleum operations.

(i) Companies with pioneer status need to file PPT returns notwithstanding that PPT is not payable during the pioneer holiday. This will enable the FIRS to verify the tax losses and unutilised capital allowances (or additions to Qualifying Capital Expenditure) accumulated during the pioneer holiday that a pioneer company intends to utilise after the holiday.

(j) The basis of reporting revenue for PPT purpose shall be higher of NNPC's Official Selling Price (OSP) or the company's crude oil sale proceeds, in compliance with Sections 9 and 23 of the PPT Act.

(k) Allowable tax deductions and tax incentives for Marginal Field operators are:

- 65.75% tax rate for operators yet to fully amortise their preproduction costs;
- 0% tax rate for gas transferred from natural gas to gas-to liquid facilities;
- 30% tax rate for upstream gas income;
- accelerated annual allowances at 20% and petroleum investment allowance from 5% to 20% depending on the water depth;
- loss incurred may be carried forward indefinitely;
- Exemption from further tax in the form of WHT on dividend paid;
- All investments necessary to separate oil from gas reserves into suitable product is considered part of oil development;
- Capital expenditures allowed for 100% write off with respect to: intangible drilling cost, exploratory & well development cost; and
- Costs incurred in the drilling of the first two appraisal wells in a field shall be fully tax deductible in the years the costs were incurred. Subsequent costs of drilling appraisal wells in the same field shall be capitalized.

28.28 Requirement for registration and filing of returns

Registration:

The legal basis for assessing upstream oil and gas companies to tax in Nigeria is Petroleum Profit Tax Act (as amended). The Act is administered by the Federal Inland Revenue Service (FIRS).Every Company incorporated to engage in petroleum operation in Nigeria is required to register with the Federal Inland Revenue Service (FIRS). The following documents and information must be submitted to the FIRS for the purpose of registering a company for tax purposes:

(a) A formal application to register the company for tax purposes. This must be on the letter head paper of the company;
(b) Completed, signed and stamped taxpayer registration input form;
(c) Copy of certificate of incorporation of the company;
(d) Copy of memorandum and articles of association ;
(e) Copy of particulars of the director of the company;
(f) Copy of shareholding of the director of the company;
(g) The full name of the company;
(h) The location address of the company;
(i) The nature of business or line of business;
(j) The date the company commenced or state that the company is yet to commence business;
(k) The names and address of the auditors of the company (if already appointed);
(l) The name and address of the company's bankers; and
(m) The name and address of tax consultants.

Filing of returns:

Every company engaged in petroleum operations is required to file returns with FIRS within three (3) months from the end of its accounting period. Such returns should contain the following particulars:

(a) Tax returns forms duly completed, signed and stamped;
(b) Audited financial statements with relevant schedules and notes to the accounts;
(c) Computation of the adjusted profit or loss;
(d) Computation of assessable profit or loss;
(e) Computation of royalties and other sums deductible under section 20;
(f) A statement of all amount repaid, refunded, waived or released to the company under section 20(5) of the PPTA;
(g) Computation of tax payable for the period or year;
(h) Monthly payment schedule;
(i) The relevant assessment year; and
(j) Evidence of payment of tax due.

28.29 The scope and administration of the Nigeria Extractive Industries Transparency Initiative (NEITI) Act, 2007

Over the years, majority of Nigerians have no idea how much money companies pay to their government and how much government also receives from the companies for doing business in the extractive sector. These payments include royalties, signature bonuses, profit tax etc. In most cases even some of those in government have little or no information of what companies pay or are expected to pay. They may also not know if what they receive is what they ought to receive from the companies.

As a result of this huge information gap, it has been difficult for an average Nigerian to explain why revenue from abundant natural resources has not translated into sustainable development. Poor information flow in the extractive sector in Nigeria is believed to be one of the reasons for poor social infrastructure, poverty, corruption, mistrust and series of social conflicts. The decision of the Federal government to sign up to the Extractive Industries Transparency Initiative (EITI) in 2003 was thus informed by the need for enhanced information, transparency and accountability on revenue flows in the sector. NEITI is the Nigerian arm of the global EITI established primarily to enthrone transparency and accountability in the management of payments made by extractive industries to government and revenues received by governments and other statutory recipients. NEITI came to prominence in Nigeria from the end of 2003. The process for its introduction in Nigeria was championed by the then President Olusegun Obasanjo. NEITI was a flagship of the reform programme of his administration, and is considered a flagship of global EITI as well. NEITI was formed in 2004 with only three civil society members, and was bolstered in June 2005 by a Civil Society Steering Committee which was designed to bring in additional civil society members and to address some of the National Stakeholder Working Group (NSWG) shortcomings. The Nigeria Extractive Industries Initiative was finally established through the NEITI Act of 2007. "Under the Act, NEITI is "charged with the responsibility for the development of a framework for transparency and accountability in the reporting and disclosure by all extractive industry companies of revenue due to or paid to the Federal Government of Nigeria" The passing of the NEITI Act in May 2007 saw the NSWG cut back to 15 members appointed by the president, but most importantly enshrined the body in law. The NEITI Act of 2007 provided legal backing to NEITI to implement EITI principles and objectives in the Nigeria extractive sector.

Objectives of Nigeria Extractive Industries Transparency Initiative (NEITI) Act, 2007

The vision of NEITI is to build a NEITI that is accountable, effective, well resourced and result oriented. The mission is to cultivate a culture of transparency, accountability, due process and zero – tolerance for corruption in Nigeria's extractive industries, for the benefit of the citizenry. Its goal is to empower the citizenry with information and data to hold government and extractive industry companies accountable and strengthen participatory democracy. The primary objectives of the NEITI are to:

a. ensure due process and transparency in the payments made by all Extractive Industry Companies to the Federal Government and statutory recipients;

b. monitor and ensure accountability in the revenue receipts of the Federal Government from Extractive Industry Companies;

c. eliminate all forms of corrupt practices in the determination, payment, receipts and posting of revenue accruing to the Federal Government from Extractive Industry Companies;

d. ensure transparency and accountability by government in the application of resources from payments received from Extractive Industry Companies; And,

e. ensure conformity with the principles of EITI.

28.30 Business sold or transferred (section17)

Consider the following situation:

(a) A business is sold by a Nigerian company to another Nigerian company for the purposes of better organisation; or

(b) There is a transfer of the management of a business to Nigeria;

(c) The assets employed in the business in (a) and/or (b) above is also sold;

(d) The Revenue Service is satisfied that one of those companies has control over the other or that both are controlled by some other person or are members of a recognised group of companies, then the following shall be applicable:

(i) If the first sale or bulk disposal of chargeable oil by the selling company has occurred, but has not occurred in case of the acquiring company:

- The first accounting period of the acquiring company shall be a period of twelve months from the date on, or within the calendar month in, which the sale of the business takes place as may be selected by the Nigerian company. This will be at the discretion of the Revenue Service and through a directive to the company to select the period. Such selection is subject to the approval of the Revenue Service; and

- Subsequent accounting periods shall also be decided by reference to this first accounting period, that is, in this situation, the company's accounting period may not necessarily be from1 January to 31December.

(ii) For capital allowance purposes, the asset sold shall be deemed to have been sold for an amount equal to the residue of the qualifying expenditure of the asset on the day following the date of sale.

(iii) Initial allowance cannot be claimed on the asset by the acquiring company and the company would be deemed to have received all capital allowances granted to the selling company up to the date of sale.

Nigerian company as used in this Section means any company incorporated under the Companies and Allied Matters Act, 2004 (as updated) or any enactment replaced by that Act.

28.31 Reconstituted company (section18)

Where:

(a) A company (the reconstituted company) is incorporated under the Companies and Allied Matters Act 2004 (as updated);

(b) The reconstituted company is to carry on any trade or business of petroleum operations previously carried on in Nigeria by a foreign company;

(c) Assets employed in Nigeria by the foreign company in that trade or business vest in the reconstituted company; and

(d) If the Revenue Service is satisfied that the trade or business carried on by the reconstituted company immediately after incorporation is not substantially different in nature from the trade or business previously carried on in Nigeria by the foreign company;

Then the following shall be applicable:

(a) If as respects the trade or business previously carried on in Nigeria by the foreign company the first sale of or bulk disposal of chargeable oil by or on behalf of the foreign company has occurred on or before the date on which the reconstituted company is incorporated:

(i) The first accounting period of the reconstituted company shall be the period of twelve months commencing on the date on which that company is incorporated, or commencing on such date within the calendar month in which the company is incorporated as may be selected by the company with the approval of the Revenue Service; and

(ii) An accounting period as respects the reconstituted company shall be a period of twelve months commencing on such date within the calendar month in which the reconstituted company is incorporated as may be selected by the company with the approval of the Revenue Service. The definition of "accounting period" shall be construed accordingly.

(b) The assets so vested in the reconstituted company shall be deemed to have been sold to it, on the day of its incorporation, for an amount equal to the residue of the qualifying expenditure.

Thereon on the day following the day on which the trade or business previously carried on in Nigeria by the foreign company ceased;

(c) The reconstituted company shall not be entitled to any initial allowances as respects those assets, and shall be deemed to have received all allowances given to the foreign company in respect of those assets; and

(d) In addition any unrelieved loss of the foreign company shall be deemed to be a loss incurred by the reconstituted company in its trade or business during its first accounting period and will be eligible for relief accordingly.

In this Section, "foreign company" means a company incorporated outside Nigeria before 18 November 1968, and having on that date an established place of business in Nigeria.

28.31.1.1 Revenue Service's power to call for returns

For the purposes of sections 17 of the Act, the Revenue Service may by notice require any person (including a company to which any assets are sold or transferred, or in which any assets have vested in Pursuance of Companies and Allied Matters Act, to complete and deliver to the Revenue Service any returns specified in the notice or any such information as the Revenue Service may require about the assets; and it shall be the duty of that person to comply with the requirements of any such notice within the period specified in the notice, not being a period of less than twenty-one days from the service thereof. (Section 17).

28.31.2 Accounts and tax computation (section28)

For each accounting period the company shall make up accounts of its profits or losses arising from petroleum operations in that period as well as the following particulars:

(a) Computations of its estimated adjusted profit or loss and of its estimated assessable profits of that period;

(b) Capital allowances computation schedules showing:

(i) the residues of its assets at the end of that period;

(ii) all qualifying petroleum expenditure incurred by it in that period;

(iii) the values of any assets disposed of in the period; and

(iv) the capital allowances due to it for the period.

(c) Computation of its estimated chargeable profits of the period;

(d) A statement of other sums, deductible under Section 20 (items deductible from assessable tax to arrive at chargeable tax), the liabilities for which were incurred during that period;

(e) A statement of all amounts repaid, refunded, waived or released during that period in respect of amounts deducted under Section 20 in prior periods; and

(f) A computation of its estimated tax for the period.

At the end of the accounting period, the actual tax payable will be computed. The tax computation based on the audited accounts of the company will be submitted to the tax office accompanied with all required documents.

28.31.3 Time limit for submission

A copy of the audited accounts of the company together with copies of all the particulars listed above are to be delivered to the Revenue Service within five months after the expiration of the company's accounting period. Such documents must be signed by a duly authorised officer of the company to the effect that they are true and complete. The Revenue Service may grant extension of the time limit if some good reason is shown by the company to the satisfaction of the Revenue Service why the company cannot comply with the deadline.

28.31.4 Returns of estimated tax (section31)

Within two months of the commencement of each accounting period, the company should submit to the Revenue Service, a return of its estimated tax for the accounting period. A revised estimated tax for the period will need to be submitted as well at any time during the accounting period that the company is aware that the original estimate requires revision.

The estimate will be replaced with the actual at the end of the company's accounting period after the statutory audit of its financial statements is concluded.

28.31.5 Unit of currency

All income tax computations made under sections 30 and 33 of PPTA shall be made in the currency in which the transaction was effected. Accordingly, and notwithstanding anything to the contrary in any law, any assessment made under section 35(1) of the PPTA shall also be made in the currency in which the computation giving rise to the assessment was made. (section 37A1 and A2).

28.32 Assessment and appeal procedures (section35)

28.32.1 Assessments

(a) The Revenue Service shall proceed to assess every company for the tax for any accounting period of the company as soon as possible after the expiration of the time allowed to such company for the delivery of the accounts and particulars provided for in section 30 of the Act.

(b) Where a company has delivered accounts and particulars for any accounting period of the company, the Revenue Service may:

- (i) Accept the same and make an assessment accordingly; or
- (ii) Refuse to accept the same and proceed as provided in subsection (3) of this section upon any failure as therein mentioned with attendant consequences.

28.32.2 Best of judgment (BOJ) assessment

Where, for any accounting period of a company, the company has:

(a) Failed to deliver accounts and particulars provided for in section 30 of the Act within the time limited by that Section; or

(b) Failed to comply with any notice given to it under the provisions of section 31 or 32 of the Act within the time specified in such notice, or within any extended time provided for in section 34 of the Act; and

(c) The Revenue Service is of the opinion that such company is liable to pay tax. The Revenue Service may estimate the amount of the tax to be paid by such company for that accounting period and make an assessment accordingly (BOJ assessment).

Such assessment shall not affect any liability otherwise incurred by such company by reason of its failure or neglect to deliver such accounts and particulars or to comply with such notices; and nothing in this subsection shall affect the right of the Revenue Service to make any additional assessment under the provisions of section 36 of the Act.

28.32.3 Additional assessments (section36)

(a) If the Revenue Service discovers or is of the opinion at any time that, with respect to any company liable to tax,

(i) tax has not been charged and assessed upon the company or

(ii) has been charged and assessed upon the company at a less amount than that which ought to have been charged and assessed for any accounting period of the company.

The Revenue Service may within six years after the expiration of that accounting period and as often as may be necessary,

- assess such company to tax for that accounting period at such amount or additional amount as in the opinion of the Revenue Service ought to have been charged and assessed, and
- may make any consequential revision of the tax charged or to be charged for any subsequent accounting period of the company (Section 36(1)).

(b) Where a revision under subsection(1) of this section results in higher amount of tax to be charged than has been charged or would otherwise be charged, an additional assessment or an assessment for any such subsequent accounting period shall be made accordingly. The provisions of the Act as to notice of assessment, objection, appeal and other proceedings under the Act shall apply to any such assessment or additional assessment and to the tax charged there under. (section 36(2))

(c) For the purpose of computing the amount or the additional amount of tax for any accounting period of a company which ought to have been charged, all relevant facts consistent with subsection (3) of section 40 of the Act shall be taken into account even though not known when any previous assessment or additional assessment on the company for that accounting period was being made or could have been made: section34(3)

(d) Notwithstanding the other provisions of this section, where any form of fraud, willful default or neglect has been committed by or on behalf of any company in connection with any tax imposed under the Act, the Revenue Service may, at any time and as often as may be necessary, assess the company on such amount as may be necessary for the purpose of recovering any loss of tax attributable to the fraud, willful default or neglect. (section 34(4)).

28.32.4 Form of assessment (section37)

(a) Assessments of tax shall be made in such form and in such manner as the Revenue Service shall authorise and shall contain:

(i) the names and addresses of the companies assessed to tax or;

(ii) of the persons in whose names any companies (with the names of such companies) have been assessed to tax;

(iii) the particular accounting period;

(iv) the amount of the chargeable profits for the period;

(v) the amount of the assessable tax for the period; and

(vi) the amount of the chargeable tax for the period. (section35(1))

(b) When any assessment requires to be amended or revised, a form of amended or revised assessment shall be made in a manner similar to that in which the original of that assessment was made under subsection (1) of this section but showing the amended or revised amount of the chargeable profits, assessable tax and chargeable tax. (section 35(2))

(c) A copy of each assessment, and of each amended or revised assessment shall be filed in a list which shall constitute the assessment list for the purpose of the Act (section 35 (3)).

28.32.5 Notices of assessment

The Revenue Service shall cause to be served personally on or sent by registered post to each person whose name appears on an assessment in the assessment list, a notice of assessment. The notice of assessment shall state:

(a) The company's accounting period;

(b) The amount of its chargeable profits;

(c) The assessable tax;

(d) The chargeable tax charged and assessed upon the company;

(e) The place at which payment of the tax should be made; and

(f) Informing such company of its rights under subsection (2) of this section (section 36 (1)).

28.32.6 Objection

If any person in whose name an assessment was made in accordance with the provisions of the Act disputes the assessment, that person may apply to the Revenue Service, by notice of objection. However,

(a) the notice of objection has to be given in writing.
(b) the taxpayer will ask the Revenue Service to review and revise the assessment.
(c) the application shall be made within twenty-one days from the date of service of the notice of assessment.
(d) it shall state the amount of chargeable profits of the company for the .accounting period in respect of which the assessment is made.

(e) it shall state the amount of the assessable tax.

(f) it shall also state the tax which such person claims should be stated on the notice of assessment (section38(2).

The Revenue Service, upon being satisfied that owing to absence from Nigeria, sickness or other reasonable cause, the person in whose name the assessment was made was prevented from making the application within such period of twenty-one days shall, extend the period as may be reasonable in the circumstances (section 38(3)).

After receipt of notice of objection referred to in subsection (2) of this section the Revenue Service may within such time and at such place as the Revenue Service shall specify, require the person giving the notice of objection to furnish such particulars as the Revenue Service may deem necessary, and may by notice within such time and at such place as the Revenue Service shall specify, require any person to give evidence orally or in writing respecting any matters necessary for the ascertainment of the tax payable, and the Revenue Service may require such evidence if given orally to be given on oath or if given in writing to be given by affidavit (section 38(4)).

28.32.7 Amended assessment

In the event of any person assessed who has objected to an assessment made upon him with respect to the amount of tax liable on assessment, such assessment shall be amended accordingly, and notice of the tax payable shall be served upon such person (section 38(5)).

28.32.8 Notice of refusal to amend

If an applicant for revision under the provisions of subsection (2) of this section fails to agree with the Revenue Service the amount of the tax, the Revenue Service shall give such applicant notice of refusal to amend the assessment as desired by such applicant, and may revise the assessment to such amount as the Revenue Service may determine and give such applicant notice of the revised assessment and of the tax payable together with notice of refusal to amend the revised assessment and, wherever requisite, any reference in the Act to an assessment or to an additional assessment shall be treated as a reference to an assessment or to an additional assessment as revised under the provisions of this subsection (Section 38(6)).

28.32.9 Errors in assessment notices

No assessment, warrant or other proceeding, purporting to be made in accordance with the provisions of the Act shall be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of a mistake, defect or omission therein, if the same is in substance and effect in conformity with or according to the intent and meaning of the Act or any Act amending the same, and if the company assessed or intended to be assessed or affected thereby is designated therein according to common intent and understanding (section39(1)).

An assessment shall not be impeached or affected

(a) By reason of a mistake therein as to:
    (i) The name of a company liable or of a person in whose name a company is assessed; or
    (ii) The amount of the tax;

(b) By reason of any variance between the assessment and the notice thereof, if in cases of assessment, the notice thereof be duly served on the company intended to be assessed or on the person in whose name the assessment was to be made on a company, and such notice contains, in substance and effect, the particulars on which the assessment is made (section39(2)).

28.32.10 Appeals from decisions of the Service

(a) A person aggrieved by an assessment or demand notice made upon him by the service of aggrieved by any action or decision of the service under the provisions of the tax laws referred to in paragraph 11, may appeal against such decision or assessment or demand notice within the period stipulated under this Schedule to the tribunal.

(b) An appeal shall be filed within a period of 30 days from the date on which a copy of the order or decision which is being appealed against is made, or deemed to have been made by the Service and it shall be in such form and be accompanied by such fee as may be prescribed provided that the Tribunal may entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for thedelay.

(c) Where a notice of appeal is not given by the appellant the period specified, the assessment or demand notices shall become final and conclusive and the service may charge interest and penalties in addition to recovering the outstanding tax liabilities which remain unpaid from any person through proceedings at the Tribunal.

28.32.11 Appeals by the Service

Service aggrieved by the non-compliance by a person in respect of any provision of the tax laws; it may appeal to the Tribunal where the person is resident giving notice in writing through the Secretary to the appropriate zone of the Tribunal.

28.32.12 Procedure before Tax Appeal Tribunal

(a) As often as may be necessary, Tax Appeal Commissioners shall meet to hear appeals in the jurisdiction or zone assigned to that Tribunal.

(b) Where Tax Appeal Commissioner has a direct or indirect financial interest in any appeal pending before the Tribunal or where the taxpayer is or was a client of that Tax Appeal Commissioner in his professional capacity, he shall declare such interest to the other Tax Appeal Commissioners and refrain from sitting in any meeting for the hearing of that appeal.

(c) The Secretary to the Tribunal shall give seven clear days notice to the Service and to the appellant of the date and place fixed for the hearing of each Appeal except in respect of any adjourned hearing for which the Tax Appeal Commissioners have fixed a date at their previous hearing.

(d) All notices documents, other than decisions Tribunal, may be signified under the hand of the Secretary.

(e) All appeals before the Tax Appeal Commissioners shall be held in public.

(f) The onus of proving that the assessment complained of is excessive shall be on the appellant.

(g) At the hearing of any appeal if the representative of the Service proves to the satisfaction of the Tribunal hearing the appeal in the first instance that:

(i) The appellant has for the year of assessment concerned, failed to prepare and deliver to the Service returns to be furnished under the relevant provisions of the tax laws mentioned in paragraph11;

(ii) The appeal is frivolous or vexatious or is an abuse of the appeal process;

(iii) It is expedient to require the appellant to pay an amount as security for prosecuting the appeal, the Tribunal may adjourn the hearing of the appeal to any subsequent day and order the appellant to deposit with the Service, before the day of the adjourned hearing, an amount, on account of the tax charged by assessment under appeal, equal to the tax charged by the assessment under appeal, whichever is the lesser plus a sum equal to ten percent of the said deposit, and if the appellant fails to comply with the order, the assessment against which he has appealed shall be confirmed and the appellant shall have no further right of appeal with respect to that assessment;

(iv) The Tribunal may, after giving the parties an opportunity of being heard, confirm, reduce, increase or annual the assessment or make any such order as it deems fit;

(v) Every decision of the Tribunal shall be recorded in writing by the Chairman and subject to the provisions of paragraph 16, a certified copy of such decision shall be supplied to the appellant or the Service by the Secretary, upon a request made within 30days of such decision.

Where upon the hearing of an appeal, it is noted that:

(i) No accounts, books or records relating to profit were produced by or on behalf of the appellant;

(ii) Such accounts, books or records were so produced but rejected by the Tribunal on the ground that it had been shown to its satisfaction that they were incomplete or unsatisfactory;

(iii) The appellant or his representative, at the hearing of the appeal, has neglected or refused to comply with a notice delivered or sent to him by the Secretary to the Tribunal, without showing any reasonable cause; or

(iv) The appellant or any person employed, whether confidentially or otherwise; by the appellant or his agent (other than his legal practitioner or accountant acting for him in connection with his ability to tax) has refused to answer any question put to him by the Tribunal, without showing any reasonable cause. The Chairman of the Tribunal shall record particulars of the same in his written decision.

28.32.13 Procedure following decision of the Tribunal

(a) Notice of the amount of the tax chargeable under the assessment as determined by the Tribunal shall be served by the Service upon taxpayer or upon the person in whose name such tax payer is chargeable.

(b) An award or judgment of the Tribunal shall be enforced as if it were a judgment of the Federal high court upon registration of a copy of such award or judgment with the Chief Registrar of the Federal High Court by the party seeking to enforce the award or judgment.

(c) Notwithstanding that an appeal is pending, tax shall be paid in accordance with the decision of the Tribunal within one month of notification of the amount of the tax payable in pursuance of subparagraph (1) of this paragraph.

28.32.14 Appeal to the Federal High Court

(a) Any person dissatisfied with a decision of the Tribunal constituted under this schedule may appeal against such decision on a point of law to the Federal High Court upon giving notice in writing to the Secretary to the Tribunal within 30 days after the date on which such decision was given.

(b) A notice of appeal shall be filed and set out all the grounds of law on which the appellant's case is based.

(c) If the Service is dissatisfied with the decision of the Tribunal, it may appeal against such decision to the Federal High Court on points of law by giving notice in writing as specified to the Secretary within 30 days after the date on which such decision was given.

(d) Upon receipt of a notice of appeal under subparagraph (1) or (2) of this paragraph, the Secretary to the Tribunal shall cause the notice to be given to the Chief Registrar of the Federal High Court along with all the exhibits tendered at the hearing before the

Tribunal.

(e) The Chief Judge of the Federal High Court may make rules providing for the procedure in respect of appeals made under this Act and until such rules are made, the Federal High Court rules relating to hearing of appeals shall apply to the hearing of an appeal under this Act.

28.32.15 Right to legal representative

(a) A complainant or appellant, as the case may be, may either appear in person or authorise one or more legal practitioners or any of its officers to represent him or its case before the Tribunal.

(b) Every individual or company in a case before the Tribunal shall be entitled to be represented at the hearing of an appeal by a solicitor or chartered accountant or adviser provided that, if the person appointed by the taxpayer to be representative in any matter before the Tribunal is unable for good cause to attend hearing thereof, the Tribunal may adjourn the hearing for such reasonable time as it deems fit, or admit the appeal to be made by some other person or by way of a written address.

28.32.16 Application of statute of limitation

The provisions of any statute of limitation shall not apply to any appeal brought before the Tribunal.

28.32.17 Powers and procedures of the Tribunal

(a) The Tribunal may make rules regulating its procedures.

(b) The Tribunal shall, for the purposes of discharging its functions under this schedule, have power to:

(i) Summon and enforce the attendance of any person and examine him on oath;

(ii) Require the discovery and production of documents;

(iii) Receive evidence on affidavits;

(iv) Call for the examination of witnesses or documents;

(v) Review its decisions;

(vi) Dismiss an application for default or deciding matters exparte;

(vii) Set aside any order or dismissal of any application for default or any order passed by it exparte; and

(viii) Do anything which in the opinion of the Tribunal is incidental or ancillary to its functions under this schedule.

(c) Any proceeding before the Tribunal shall be deemed to be a judicial proceeding and the tribunal shall be deemed to be a civil court for all purposes.

(d)

28.32.18 Minister to make rules and regulations

The Minister may make rules prescribing the procedure to be followed in the conduct of appeals before the Tribunal.

28.32.19 Costs

Each party to an appeal shall bear its own cost

28.32.20 Further appeals

An Appeal against the decision of the Federal High Court at the instance of either party shall lie to the Court of Appeal and Supreme Court.

28.33 Persons chargeable

Section 24(1) of the Act makes it an offence for any person (other than a company) to engage in petroleum operations in any form with a view to sharing the profits arising from such operations. It is therefore certain that PPT is payable only by companies. Where companies are engaged in petroleum operations in partnership or in a joint venture under any scheme or arrangement, the Minister may make rules modifying the provisions of the PPTA for the ascertainment of the tax to be charged and assessed upon each of the companies involved. The effect of any such rules shall not be to impose a greater burden of tax on any company engaged in such partnership or joint venture than the proportion of its share of the benefits there from.

28.33.1 Non-resident company (Section 25)

A non-resident company engaged in petroleum operations shall be assessable and chargeable to tax as if it were resident either, directly or in the name of its manager, or in the name of any other person who is resident in Nigeria and employed in the management of the petroleum operations of the company.

The person in whose name a non-resident company is assessable and chargeable to tax shall be answerable –

(a) for all matters required to be done by virtue of the Act for the assessment of the tax as might be required to be done by such non- resident company if it were resident in Nigeria, and

(b) for paying any tax assessed and charged in the name of such person.

28.33.2 Resident company (section26)

The manager or any principal officer in Nigeria of every company engaged in petroleum operations shall be answerable for doing all such acts as are required to be done by virtue of the Act for the assessment and charge to tax of such company and for payment of such tax.

28.33.3 Company in receivership or liquidation (Section27)

A company being wound up or under a receiver may be assessed and charged to tax, in the name of the liquidator or receiver or any agent of the liquidator or receiver, for any accounting period whether before, during or after the date of appointment of the liquidator or receiver. Any such liquidator, receiver or agent shall be answerable for doing all such acts as are required to be done by virtue of the Act, for the assessment and charge to tax of such company and for payment of the tax. The distribution of the assets of the company to the shareholders or debenture holders thereof should not be made unless adequate provision has been made for the payment in full of any tax which may be found payable by the company.

28.34 Collection and payment of tax

28.34.1 Payment dates

The tax for any accounting period shall be payable in twelve equal monthly installments together with a final installment. The first monthly installment is due and payable not later than the third month of the accounting period. The amount payable is one-twelfth of the estimated tax for the year. A "returns of estimated tax" is expected to have been made by the company to the Revenue Service in accordance with the provision of section 33(1) and should have been filed not later than two months from the commencement of the accounting period. It is the estimated tax on such returns that will be divided into twelve for the purpose of the monthly installments payable.

Where the accounting period is less than one year, the amount payable shall be proportional to the total number of months in the period. Subsequent monthly installments are due and payable not later than the last day of the month in question. The final installment is due and payable within twenty-one days after the service of the notice of assessment of tax for the accounting period. The amount of this final installment is the amount of tax assessed for the accounting period less the total of the amounts paid by the twelve installments. The payment dates in respect of each accounting period are summarised below:

28.34.2 Petroleum Profits Tax payment dates

Instalment	Payment dates
1st Due and pay able by	31 March of the accounting period 2nd
Due and pay able by	30 April of the accounting period 3rd Due
and pay able by	31 May of the accounting period 4th Due
and pay able by	30 June of the accounting period 5th Due

and pay able by	31 July of the accounting period 6th Due
and pay able by	31 August of the accounting period
7th Due and pay able by	30 September of the accounting period 8th
Due and pay able by	31 October of the accounting period 9th
Due and pay able by	30 November of the accounting period 10th
Due and pay able by	31 December of the accounting period
11th Due and payable	31 January of the next accounting period
12th Due and payable	28 or 29 February of the next accounting period

28.34.3 Tax subject to objection or appeal

Where any tax is a subject of an objection or appeal, that tax shall be held over, pending the result of the objection or appeal. Nevertheless, the Revenue Service may enforce payment of that portion of the tax (if any) which is not in dispute. The tax outstanding under the assessment as determined on such objection or appeal as the case may be is payable as follows:

(a) The amount of the tax held over is payable immediately; and

(b) While any additional sum to the amount held over is payable within one month from the date of service of the notification of the tax payable.

28.34.3.1 Penalty

If any installment of tax due and payable is not paid within the appropriate time limit referred to above, a penalty of 5% of the amount of the installment shall be added and become payable. (Note that the rate is stated as 5% in the Act, it is not stated as "per annum" as the case is with the equivalent penalty applicable in CITA and PITA). A demand note. will thereafter be served on the company and payment is to be made (of the tax and the penalty) within one month of the date of the service of the demand note. Any company who without lawful justification or excuse, the proof of which is on the company, fails to pay the tax within this period of one month shall be guilty of an offence. The Revenue Service may, for any good cause shown, remit the whole or any part of the penalty.

28.34.3.2 Error or mistake claim

The provisions in Section 49 of PPTA with regard to error or mistake claim are as follows:

(a) If any person who has paid tax for any accounting period alleges that, assessment made upon him or in his name for that period, was excessive by reason of some error or mistake in the accounts, particulars or other written information supplied by him to the Revenue Service for the purpose of the assessment, such person may make an application in writing to the Revenue Service for relief. Such an application can be made at any time not later than six years after the end of the accounting period in respect of which the assessment was made;

(b) On receiving such application, the Revenue Service shall inquire into the matter and subject to the provisions of this section shall, by way of repayment of tax, give such relief in respect of the error or mistake as appears to the Revenue Service to be reasonable and just;

(c) No relief shall be given if such accounts, particulars or information was in fact made or given on the basis or in accordance with the practice of the Revenue Service generally prevailing at the time when such accounts, particulars or information was made or given. In other words, an error in the basis of assessment through the application of a practice then prevailing is not a ground for relief;

(d) In determining any application under this Section the Revenue Service shall have regard to all the relevant circumstances of the case, and in particular shall consider whether the granting of relief would result in the exclusion from charge to tax of any part of the chargeable profits of the applicant, and for this purpose the Revenue Service may take into consideration the liability of the applicant and assessments made upon him in respect of other years; and

(e) No appeal shall lie from a determination of the Revenue Service under this section, which determination shall be final and conclusive.

28.35 Repayment of tax

The Revenue Service shall give a certificate of the amount of any tax to be repaid under any of the provisions of the PPTA or under any order of a court of competent jurisdiction. Upon the receipt of the certificate, the Accountant General of the Federation shall cause repayment to be made in conformity with the certificate. Repayment claim must be made in writing within six years next after the end of the accounting period to which it relates. If the Revenue Service disputes any such claim, a notice of refusal to admit the claim shall be given to the claimant and the provisions of the Act with regard to objections and appeals shall apply with any necessary modifications.

28.36 Deduction of tax at source

Similar to the provision of section 81 of CITA, section 56 has been inserted in PPTA by Decree No. 21 of 1991. The section provides for deduction of withholding tax from payments due to any company, partnership, or person, (whether or not resident in Nigeria) who provides petroleum operations services and related activities to a company carrying on petroleum operations in Nigeria.

The services and activities affected and the applicable rates are: Nature of service or activity

	Rates of withholding tax	
	Companies	Individuals
All aspects of building construction and related activities	5%	5%
All types of contracts other than sale and Purchase of goods and property	5%	5%
Consultancy and professional services	10%	5%
Management services	10%	5%
Technical services	10%	5%
Commissions	10%	5%

Other relevant provisions of the subsidiary legislation are:

(a) The deductions are not and should not be regarded as additional cost of contracts or services rendered and should therefore not be built into costs. They are deductions in lieu of tax;

(b) A person who had deducted tax from such payments shall issue a receipt for the amount of tax deducted and a statement showing details prescribed in paragraph 4 below;

(c) Such person shall forward the tax deducted and the accompanying statement to the relevant Tax Authority of the State in which the individual, receiving the payment, is residents

(d) The person making the remittance of the deduction made shall state the following information in writing:

(i) Name and address of the person who suffered the tax deduction;

(ii) Nature of activities or services in respect of which payments were made;

(iii) Gross amount paid or payable;

(iv) Amount of tax deducted;

(v) Amount of tax remitted; and

(vi) Date of remittance.

(e) For the purpose of final assessment, the individual beneficiary of such income that had suffered deduction of tax at source shall present the original receipt issued in respect of the tax deducted at source, to the relevant Tax Authority for scrutiny whenever a claim for tax credit is made;

(f) Tax deducted from payments made to companies shall be remitted to any of the offices of the Federal Inland Revenue Service;

(g) Deductions at the rates specified above from payments made to a person shall be remitted only to the relevant tax authority of the State in which the person, that is the recipient of the payment, is deemed to be resident; and

(h) A body corporate or un–incorporate and any association or institution obliged to deduct tax at source under the Act and by virtue of this notice, but who fails to do so or having deducted tax, fails to pay over such tax to the relevant tax authority within thirty days from the date the tax was deducted or duty to deduct tax arose, shall be liable on conviction to a fine of 5,000 in addition to the amount of tax deducted or not deducted together with interest at the prevailing commercial rate. Such payments may also be disallowed as deduction in ascertaining the income or loss for tax purposes of the body corporate or un-incorporate, association or institution.

28.37 Offences and penalties

The following are offences and the related penalties as specified in
PPTA: Offences Penalties

(a)	Failure to comply with the requirements of a notice served by the Revenue Service.	A fine of ₦10,000. Where the offence arose from failure to deliver accounts or particulars or returns, a further sum of ₦2,000 for each and every day during which the failure continues. In default of payment is imprisonment for six months.
(b)	Failure to make up accounts of the company's profits or losses and prepare necessary particulars.	As for (1) above.
(c)	Failure to attend, without sufficient cause, in answer to a notice or summons served by the Revenue Service or having attended, failure to answer any question lawfully put.	As for (1) above.
(d)	Failure to submit the return of the company's estimated tax within two months of the commencement of the commencement of an accounting period. Failure to submit a revision of the estimate when necessary, is also an offence.	As for (1) above.
(e)	Preparation of incorrect accounts of the tax which has been undercharged and particulars or schedules in consequence of such incorrect required by the Act document or information.	A fine of ₦1,000 and double the amount (understating profits or overstating losses).
(f)	Giving any incorrect information in relation to any matter or thing affecting a person's liability to tax.	As for (5) above.
(g)	Knowingly making any false statement or false representation or using any forged document with a view to obtaining deduction.	A fine of ₦1,000 plus treble the amount of tax involved or to imprisonment for six months, or to both such fine and imprisonment.
(h)	Aiding, abetting, assigning, counseling, inciting or inducing any other person to: (a) Prepare and submit false accounts and returns or (b) refuse or neglect to pay tax.	As for (7) above.
(i)	Any member of the Revenue Service or any assistant employed in connection with the assessment and collection of tax who	A fine of ₦600 or imprisonment for three years or to both such fine and imprisonment.

(i) Demands an amount in excess of the authorised assessment of tax payable.

(ii) Withholds for his own use or otherwise part of the tax collected.

(iii) Renders a false return (verbal or written) of the amount collected by him.

(iv) Defrauds, embezzles or otherwise uses his position to deal wrongfully either with the Revenue Service or any other individual.

(v) Collects or attempts to collect the tax without being authorised shall be guilty of an offence.

(j)	Failure to deduct withholding tax or failure to remit the tax deducted to Federal Inland Revenue Service within 30 days.	A fine of 200% of the tax not withheld or not remitted plus interest at the prevailing commercial rate.

The penalty that applies to any other offence under the Act for which the penalty is not specifically stated is as in (1) above, that is, a fine of ₦10,000 plus ₦2,000 per day where the offence has to do with failure to deliver a return. An example of an offence for which a penalty is not specifically stated is the failure to pay tax and penalty within one month of the date of issuing a demand note.

The institution of proceedings for or the imposition of a penalty, fine or term of imprisonment in accordance with the provisions of the Act shall not relieve any person from liability to payment of any tax for which he is or may become liable.

28.38 Double taxation arrangement (section61)

(a) If the Minister by order declares that arrangements specified in the order have been made with the Government of any territory outside Nigeria with a view to affording relief from double taxation in relation to tax imposed under the provisions of the Act and any tax of a similar character imposed by the laws of that territory, and that it is expedient that those arrangements should have effect, the arrangements shall have effect notwithstanding anything in any enactment.

(b) The Minister may make rules for carrying out the provisions of any arrangements having effect under this section.

(c) An order made under the provisions of subsection (1) of this section may include provisions for relief from tax for accounting periods commencing or terminating before the making of the order and provisions as to income (which expression includes profits) which is not itself liable to double taxation.

(d) Where, before the publication of the Act in the Federal Gazette upon enactment, any order has been made under the provisions of Section 33 of the Income Tax Act and the arrangements specified in that order, with any modifications, are expressed to apply to a tax in a territory outside Nigeria and to income tax in Nigeria and to any other taxes of a substantially similar character either imposed in that territory or Nigeria or imposed by either contracting party to any such arrangements after those arrangements came into force and:

(i) Such order was made before 1 January, 1958, then, for the purposes of the Act, that order shall be deemed to have been made under this Section on that day, and those arrangements shall have effect, in Nigeria, as respects tax for any accounting period; or

(ii) Such order was made on a day after the year 1957, then, for the purposes of the Act, that order shall be deemed to have been made under this Section on that day and the arrangements specified therein shall have effect, in Nigeria, as respects tax for any accounting period beginning on or after the date when those arrangements come into force, and for the unexpired portion of any accounting period current at that date; and where any arrangements, to which this subsection applies, counting a provision for exchange of information with the Minister as defined in section 2 of the Income Tax Act then the order, with respect to those arrangements, as deemed to have been made under this section, shall be deemed to provide for such exchange with the Chairman of the Revenue Service as respects tax.

(e) The Minister may by order replace or vary any order deemed to have been made under this Section for the purposes of the Act, without otherwise affecting such last-mentioned order for the purpose of any other Act.

28.38.1 Relief for double taxation (Section 62)

(a) The provisions of this section shall have effect where, under arrangements having effect under section 61 of the Act, foreign tax payable in respect of any income in the territory with the Government of which the arrangements are made is to be allowed as a credit against tax payable in respect of that income in Nigeria; and in this section the expression "foreign tax" means any tax payable in that territory which, under the arrangements, is to be so allowed, and "income "means that part of the profits of any accounting period which is liable to both tax and foreign tax, before the deduction of any tax, foreign tax, credit therefore or relief granted under subsection (6) of this section.

(b) The amount of the credit admissible to any company under the terms of any such arrangements shall be set off against the tax chargeable upon that company in respect of the income, and where that tax has been paid the amount of the credit may be repaid to that company or carried forward against the tax chargeable upon that company for any subsequent accounting period.

(c) The credit for an accounting period shall not exceed whichever is the lower of the following amounts, that is to say:

(i) The amount of the foreign tax payable on the income; or

(ii) The amount of the difference between the tax chargeable under the Act (before allowance of credit under any arrangements having effect under Section 61 of the Act) and the tax which would be so chargeable if the income were excluded in computing profits.

(d) Without prejudice to the provisions of subsection (3) of this Section, the total credit to be allowed to a company for any accounting period for foreign tax under all agreements having effect under Section 61 of the Act, shall no exceed the total tax which would be ultimately borne by that company, for that accounting period, if no such credit had been allowed.

(e) Where the income includes a dividend and under the arrangements foreign tax not chargeable directly or by deduction in respect of the dividend, is to be taken into account in considering if any, and if so, what credit is to be given against tax in respect of the dividend. The amount of the income shall be increased by the amount of the foreign tax not so chargeable, which falls to be taken into account in computing the amount of the credit.

(f) Where the amount of the foreign tax attributable to the income exceeds the credit therefore computed under subsection (3) of this section, then the amount of that income to be included in computing profits for any purpose of the Act other than that of subsection (3) of this section, shall be taken to be the amount of that income, increased by the amount of the credit therefore after deduction of the foreign tax.

(g) Where:

(i) The arrangements provide, in relation to dividends of some classes, but not in relation to dividends of other classes, that foreign tax not chargeable directly or by deduction in respect of dividends, is to be taken into account in considering, if any, and if so, what credit is to be given against tax in respect of the dividends; and

(ii) A dividend is paid which is not of a class in relation to which the arrangements so provide, then, if the dividend is paid to a company which controls, directly or indirectly, not less than half of the voting power in the company paying the dividends, credit shall be allowed as if the dividend were a dividend of a class in relation to which the arrangements so provide.

(h) Any claim for an allowance by way of credit shall be made not later than three years after the end of the accounting period, and in the event of any dispute as to the amount allowable the Revenue Service shall give to the claimant notice of refusal to admit the claim which shall be subject to appeal in like manner as an assessment.

(i) Where the amount of any credit given under the arrangements is rendered excessive or insufficient by reason of any adjustment of the amount of any tax payable either in Nigeria or elsewhere, nothing in the Act limiting the time for the making of assessments or claims for repayment of tax shall apply to any assessment or claim to which the adjustment gives rise, being an assessment or claim made not later than three years from the time when all such assessments, adjustments and other determinations have been made, whether in Nigeria or elsewhere, as are material in determining whether any, and if so what, credit falls to be given.

(j) Where a company is not resident in Nigeria throughout an accounting period, no credit shall be admitted in respect of any income included in profits of that company for that period.

28.39 Tax on sale of gas

28.39.1 Natural gas

"Natural gas means gas obtained in Nigeria from bore holes and wells and consisting primarily of hydrocarbons".

28.39.2 Chargeable natural gas

In relation to a company engaged in petroleum operations means natural gas actually delivered by a relevant company to the Nigeria National Petroleum Corporation under a gas sales contract but does not include natural gas taken by or on behalf of the Government of the Federation in pursuance of the petroleum tax Act.

28.39.3 Non-associated gas

On the other hand, in Nigeria, we do have exclusive gas reservoirs that may or may not include any amount of crude oil. “Non- associated gas” is defined as “natural gas not in contact with reservoirs that contain significant quantities of crude oil”. Indeed, there are publications that see Nigeria as more of a gas region than of oil region.

28.39.4 Associated gas

This is involuntarily produced with oil. As crude oil is extracted from the bore holes the gas automatically comes with it. It could be described as a by product of crude oil. Consequently, where it is present and crude oil must be extracted associated gas must be extracted.

28.39.5 The value of natural gas

For any Petroleum producing company, the ascertainment of the value of all chargeable natural gas in the accounting period shall be the sum of gross proceeds under individual gas sales contracts in the accounting period less the G-Factor allowance **[gas production cost adjustment factor]** as applicable to any such individual gas sales contracts at the appropriate rate percent of such individual gas sales contract as specified in the **table to the fourth** schedule to the PPTA as stated below:

Fourth schedule table;

Load Factor	G-Factor Per centum [%]
50	16.9
60	15.5
70	14.3
80	13.6

The Government of the Federation may from time to time review the G-factor allowance specified in the table to this schedule.

G. Factor per centum in respect of factors in between the standard stated figures mentioned in the table to this schedule

Where the load factor is between the figures given on the table, the G-factor (%) shall be calculated on pro-rata basis as stated below:

Use of simple average

Where load factor is 55: G -factor allowance

$$= \frac{16.9 + 15.5}{2} = 16.2\%$$

Use of interpolation rule

Statistically, when the load factor is in between the standards stated in the schedule, the G – factor can be determine using the interpolation method stated below;

$$GFL - \frac{LFL – GLF}{LLF - LFU} [GFL - GFU]$$

Where:

GFL = G- Factor allowance of the lower boundary to the given Load factor.

LFL= Load Factor of the lower boundary to the given Load factor. GLF = the given Load Factor not in the standard table.

GFL = the G Factor to the Lower boundary Load Factor. GFU = the G Factor to the Upper boundary Load Factor. LLF = the Load Factor of the lower boundary.

LFU = the Load Factor of the Upper boundary. Illustration

Where the load factor is: 56 and 72. Determine the G-factor allowances

Load factor56;

$$16.9 - \frac{50-56}{50-60} \times [16.9 - 15.5]$$

$$= 16.9 - \frac{-6}{-10} \times [1.4]$$

$$= 16.9 - 0.6\ [1.4]$$

$$= 16.9 - 0.84$$

$$= \underline{16.06\%}$$

Load factor 72;

$$14.3 - \frac{70-72}{70-80} \times [14.3 - 13.6]$$

$$= 14.3 - \frac{-2}{-10} \times [0.7]$$

$$= 14.3 - 0.2[0.7]$$

$$= 14.3 - 0.14$$

$$= 14.16\%$$

Illustration

Orente Limited derives income from individual natural gas sales contract asfollows:

Contract with;

		Load factor	Gross proceed (₦m)
(i)	AdetolaniLtd	50	54
(ii)	AdekolajoLtd	75	4.8
(iii)	Wuraola Ltd	80	2.4

Required: Compute the income derived from sale of gas. Suggested solution to illustration;

Orente Ltd

Computation of Income from gas sales

		N= '000	N= '000
(i)	Adetolani Ltd;		
	Gross sales	5,400.00	
	G-factor allowance:		
	16.9 x5,400	(912.60)	4,487.40
	100		
(ii)	Adekolajo Ltd;		
	Gross sales	4,800.00	
	G-factor allowance:		
	13.95 x4,800		
	100(669.60)		4,130.40
(iii)	Wuraola Ltd;		
	Gross sales	2,400.00	
	G-factor allowance:		
	13.6 x2,400	(326.40)	2,073.60
	100		
	Income from gas sales		N=10,691.40

The income from gas sales as ascertained above will be subjected to tax under the Company Income Tax [CITA] provision. Allowable expenses are granted to arrive at the adjusted profit. Balancing charge is added to arrive at the assessable profit. Loss relief and capital allowance are granted to arrive at the total profit. The company income tax is computed as 30% of the total profit. Education tax is computed as 2% of the assessable profit.

28.39.5.1 Gas industry incentives

The following were the major disincentives to gas production in Nigeria prior to January 1, 1997:

(a) High Corporate tax rate particularly the Petroleum Profits Tax rate as the taxation of gas is under the Petroleum Profits Tax Act;

(b) Limited market;

(c) Limited numbers of appropriate reservoirs conducive for gas reinjection/storage and the economies of doing so;

(d) The huge cost of developing major and inter-connecting network of gas pipelines;

(e) Low technological and industrial base for energy consumption in the country and limited regional and international gas market;

(f) Inadequate fiscal and gas pricing policies to encourage investment; and

(g) The difficult terrain of the Niger Delta which hinder the gas gathering process.

With effect from 1 January 1997, a Section 10A was inserted in the Petroleum Profits Tax Act, with the following provisions:

(a) The following incentives shall apply to a company engaged in the utilisation of associated gas, that is:

  (i) Investment required to separate crude oil and gas from the reservoir into usable products shall be considered as part of the oil field development;

  (ii) Capital expenditure to deliver associated gas in usable form at utilisation or designated custody transfer points shall be treated for tax purposes, as part of the capital investment for oil field development;

  (iii) Capital allowances, operating expenses and basis of tax assessment shall be subject to the provisions of the Act and the tax incentives under the revised MOU.

  (iv) Gas to be transferred at 0% royalty and 0% Petroleum Profit Tax.

  (v) Plant and machinery for gas utilisation are exempted from import duties.

(b) The incentives specified under subsection (1) of this Section shall be subject to the following conditions, that is:

  (i) Condensates extracted and re-injected into the crude oil stream shall be treated as oil but those not re-injected shall be treated under existing tax arrangement;

  (ii) The company shall pay the minimum amount charged by the Minister of Petroleum Resources for any gas flared by the company;

  (iii) The company shall, where practicable, keep the expenses incurred in the utilisation of associated gas separate from those incurred on crude oil operation and only expenses not able to be separated shall be allowable against the crude oil income of the company under the Act;

  (iv) Expenses identified as incurred exclusively in the utilisation of associated gas shall be regarded as gas expenses and be allowable against the gas income and profit to be taxed under the Companies Income Tax Act;

  (v) Only companies which invest in natural gas liquid extraction facilities to supply gas in usable form to downstream projects, including aluminium smelter and methanol, Methyl Tertiary Butyl Ether and other associated gas utilisation projects shall benefit from the incentives;

(vi) All capital investments relating to the gas to liquids facilities shall be treated as chargeable capital allowance and recovered against the crude oil income;

(vii) Gas transferred from the natural gas liquid facility to the gas-to- liquids facilities shall be at zero per cent tax and zero per cent royalty.

There is apparently no distinction between associated gas and non- associated gas in the Petroleum Profits Tax Act. All incentives in respect of investments in associated gas also apply to investments in non- associated gas.

28.40 Chapter review

Having read through this chapter, readers must have appreciated the administrative procedure of Nigeria's oil and gas. In addition, profits as specifically defined for oil and gas, the computation of adjusted profits, assessable profit, chargeable profit, assessable tax, chargeable tax, petroleum investment allowance, investment tax credit, memorandum of understanding, upstream/downstream matters, gas flaring and process of taxing natural gas must have been fully understood.

28.41 Worked examples

28.41.1 Open-ended questions

Question 1

Odiok Oil Producing Company is engaged in Petroleum operations. The following information are extracted from the books of accounts of the company for the period

1st January to 31 December, 2013	₦'000	₦'000
a. Value of crude oils old		

Exported	50,000		
Domestic	10,000	60,000	
Deduct: Production cost	2,000		
Transportation	1,000		3,000
		57,000	
Deduct: Recurrent Administrative and overhead expenses			
Salaries	500		
Bank charges and interest	50		
General overheads	250		
Interest on bills payable	200		
Royalties and producing rentals	12,000		
Non-productive rent	150		
Loss on disposal of fixed assets	50		
Customs duties	250		
Harbour dues	50		
Depreciation	2,500		16,000
Net Profit			41,000

b. Other relevant details are:

		₦'000
(i)	Royalties on domestic crude oil sales	2,000
(ii)	Intangible drilling costs capitalised	5,000
(iii)	Capital allowances were as follows:	
	- Annual allowance	20,000
	- Balancing charge	500
	- Unrelieved capital allowance brought forward from the previous year	16,000
	Pet. Invest. Allowance	2,500

i. Posted prices of crude oil is US$30.20 per barrel at the standard API gravity of 300.
ii. For every degree decrease in API gravity below the standard API gravity, the posted price is decreased by US $0.05. The reverse is to increase the posted price.
iii. Crude oil exported during the accounting period totaled 3,000,000 barrels, the API being 260.
iv. One Naira is equivalent toUS$1.50.
v. Profits from petroleum exported or sold locally are taxable at 85 percent.
vi. Loss b/f is₦1,000,000

.

Required;

Compute chargeable tax payable.

Question 2

Koko Oil Nigeria Ltd. has been in business for many years. It's Profit/ Loss Account for the year ended 31 December, 2012 showed the following:

	₦	₦
Sales		34,000,000
Closing stock		1,000,000
		35,000,000
Less:		
Opening	500,000	
Production and transportation costs	6,300,000	6,800,000
		28,200,000
Less:		
Administrative expenses	1,389,500	
Loan interest	3,400,000	
Royalties, customs duties etc	7,000,000	
Stamp duty on debenture	90,000	
Depreciation	5,000,000	16,879,500
Profit before tax		11,320,500

Note:

a. Interest in respect of loan received from a subsidiary (strictly on commercial basis) included in loan interest of ₦3,400,000 charged amounted to ₦2,000,000.

b. Royalties on local sale of crude oil was ₦620,000.

c. Harbour dues of ₦200,000, Customs Duties of ₦300,000 and dead rent of ₦150,000 are included in the sum of ₦7,000,000 charged the account.

d. Intangible drilling expenditure of ₦2,650,000 incurred during the year has been capitalised as petroleum expenditure.

Required:

Prepare an adjusted profit of the company for the purpose of petroleum profit tax for the relevant year of assessment.

Question 3

Odiosac Oil and Gas Company Ltd is engaged in petroleum operations. You have been given the following information in respect of the company for the year ended 31 December, 2013.

		Export	Local
a.	Crude oil sold (in barrels)	6,000,000	3,000,000
	Applicable posted/selling prices	US$30.00	₦15
		₦	₦
	Recurrent administrative and productive expenses	10,050,000	
	Intangible drilling expenditure	1,800,000	
	Exploration expenses	900,000	
	First two appraisal wells expenditure	900,000	
	Customs duties on essential equipment 450,000 Royalty on crude oil sold (including ₦500,000 for domestic sales)		12,500,000
	Non -production concession rental onshore Petroleum		180,000
	Investment allowance	120,000	
	Revenue received from Ughelli Oil company Ltd for the use of company's pipelines	500,000	
	Profit on disposal of fixed assets	5,000	
	Sales of scrap to local customers 100,000 Dividend received from Onitsha Oil company, a company also engaged in petroleum operations	50,000	655,000

b. Other relevant details are:

	(i) Terminal expenses	200,000
	(ii) Commission paid to the Central Bank of Nig. On tax payments	10,000
	(iii) Loss on exchange arising from monthly tax payments	500,000
(iv)	Offshore concession rentals	200,000
(v)	Donation to Ogboru Women's Society (included in recurrent Administrative expenditure	50,000
(vi)	Annual allowance computed for The accounting period	1,000,000
(vii)	One Naira is equivalent to US$1.50	

c Balancing charge and balancing allowances on disposals made during the year amounted to ₦100,000 and ₦50,000 respectively

d. The company realised ₦1,500,000 from the sale of natural gas to Sapele Gas Company, a company which generates electricity, using gas. Losses b/f amounted to₦250,000.

Required;
You are required to compute the chargeable tax for the accounting period.

4 Adelab Oil (Nig.) Ltd is an oil producing company. Crude oil lifting for the 2014 accounting period were at the rate of 4,000 barrels per day. The company confirmed that 95 percent of the crude oil lifted was exported while the remaining 5 percent was sold in the home market (i.e. domestic sales). Other relevant details are asfollows:

(a) Gross posted price of crude oil of 350 was ₦ 20.55 and it had been agreed with the Federal Government that for every degree decrease in the API gravity of crude oil exported, the posted price was to be reduced by ₦0.11 kobo. The API gravity of crude oil exported was 300.

(b) Sale of crude oil

	₦	₦
Export	26,353,000	
Domestic	1,095,000	
Less: Production cost		584,000
Transportation		1,500,000
		2,084,000
		25,364,000
Deduct: Salaries	500,000	
General overheads	70,000	
Bank charges and interest	75,000	
Interest on bills payable		93,000
Interest on loan from subsidiary		
company at commercial rate	160,000	
Loss on disposal of fixed assets	25,000	
Depreciation	1,450,000	
Royalties and producing rentals	6,500,000	
Non producing rentals	60,000	
Customs duties	30,000	
Harbour dues	24,000	
		8,987,000
Profit before taxation		16,377,000

(c) The company has capitalised intangible drilling costs amounting to ₦1,500,000.

(d) Royalties on domestic sales were ₦292,000.

(e) Capital allowances for the year were:

Annual	₦1,700,000
Balancing charge	₦15,000

(f) Petroleum investment allowance as agreed ₦200,000

(g) Capital allowances brought forward from previous year were ₦250,000

(h) The company executed the production sharing contract (PSC) with the Nigerian

National Petroleum Corporation (NNPC) in 1993. The proportion of the percentage of profit oil split is 30% and 70% for NNPC and Adelab Oil Nigeria Ltd respectively.
You are required to compute:

(i) Adjusted Posted price of crude oil exported

(ii) The assessable profit for the accounting period

(iii) Chargeable petroleum profit

(iv) Assessable petroleum profit tax

(v) Chargeable tax.

28.41.2 Suggested solutions to open-ended questions

1

Odiok Oil Producing Company
Computation of chargeable tax for 2013 year of assessment

	₦	₦
Fiscal value of chargeable exported (wi)		60,000,000
Domestic sales		10,000,000
Net fiscal value of chargeable oil		70,000,000
Incidental Income: Balancing charge		500,000
Total Income		70,500,000
Deduct:		
Production cost		2,000,000
Transportation		1,000,000
Salaries		500,000
Bank charges and Interest		50,000
General overheads		250,000
Royalties and producing rentals		10,000,000
Royalties on domestic crude oil sales		2,000,000
Non - productive rent		150,000
Customs duties		250,000
Harbour dues		50,000
Intangible drilling cost		5,000,000
Education tax (wii)	965,686	(22,215,686)
Adjusted Profit		48,284,314
Unrelieved loss b/f		(1,000,000)
Assessable Profit		47,284,314
Capital allowance (wiii)		(36,791,667)
Chargeable Profit		10,492,647
Chargeable tax @ 85%		₦8,918,750

Workings

i) Value of chargeable oil exported Number of barrels is 3,000,000

Adjusted posted price	US$
Posted price	30.20
Adjustment:	
(30o - 26o) x $0.05	(0.20)
Adjusted posted price	30
	====

Fiscal value of chargeable oil exported;

Number of barrels exported x Adjusted posted Price

= 3,000,000 barrels x US$30

= US$990,000,000

Naira equivalent: $\frac{\text{₦90,000,000}}{\$1.5}$

= ₦60,000,000

ii) Education tax

= (Total Income - All expenses before charging education tax x 2/102

= ₦ (70,500,000 - 21,250,000) x2/102

= ₦965,686

iii) Capital allowance

	₦
Lower of:	
Capital allowance b/f	16,000,000
+ Annual allowance FTY	20,000,000
+ Petroleum Investment. Allowance (PIA)	2,500,000
(a) Capital allowance for the year	38,500,000
Restricted to:	
85% of ₦47,284,314	41,041,667
Less 170% of ₦2,500,000	(4,250,000)
	36,791,667
Capital allowance claimed is	₦36,791,667
Capital allowance c/f	₦1,708,333

2

Method 1-

Koko Oil Nigeria Ltd computation of adjusted profit

For 2012 tax year

₦		₦
Sales		34,000,000
Deduct: cost of sales:		
Production and transportation		6,300,000
Add closing stock		1,000,000
		7,300,000
Deduct opening stock	(500,000)	6,800,000

Income from, petroleum operation		27,200,000
Deduct:		
Interest on loan - subsidiary		2,000,000
Interest on loan - others		1,400,000
Royalties on local sales		620,000
Harbour due		200,000
Customs duties		300,000
Dead rent		150,000
Intangible drilling cost		2,650,000
Administrative expenses		1,389,500
Royalties customs duties		5,730,000
Education tax	250,206	14,689,706
Adjusted profit		12,510,294

Workings

1 - Education tax

₦27,200,000 - 14,439,500] x 2/102 =₦250,206

Method 2 - Net Profit approach Koko Oil Nigeria ltd . preparation of adjusted profit

For 2012 year of assessment	₦	₦
Profit before tax		11,320,500
Deduct; stock variation (note1)		1,000,000
Add (deduct);		10,320,500
Intangible drilling expenditure (2,650,000) Stamp duty on debenture	90,000	
Depreciation	5,000,000	
Education tax(note 2)	(250,206)	2,189,794
Adjusted profit		12,510,294

Notes:

1) Stock variation-The closing stock was increased by₦500,000.
   By implication the profit before tax was wrongly increased instead of reducing it. Remember that it is the quantity of oil produced in a respective accounting period and not the quantity actually sold that is chargeable to tax.

   Consequently, the stock adjustment required is ₦1,000,000 to firstly remove the impact of wrong increment of ₦500,000 and secondly remove the impact of ₦500,000 on sales to arrive effectively at the value of chargeable oil produced.

2) Education tax
   (Total Income - Allowable expenses before charging education tax) x 2/102
   ₦ (10,320,500 - (-2,650,000 + 90,000 + 5,000,000) x2/102
   ₦ (10,320,500 + 2,440,000) x2/102 = ₦250,206

3) Odiosac Oil and Gas Company Limited
   Computation of chargeable tax
   For 2013 tax year

	₦	₦
Export (i.e. $30/$1.5)x6,000,000barrels)		120,000,000
Local sales (₦15x3,000,000)		45,000,000
Net fiscal value ofchargeableoil		165,000,000
Add: Incidental Incomes:		
Use ofcompany'spipelines	500,000	
Salesofscrap	100,000	
Balancing charge	100,000	700,000
TotalIncome		165,000,000
Deduct;		
Recurrent admin.		
Expenditure ₦(10,050,000-50,000)	10,000,000	
Intangible drilling expenditure	1,800,000	
Exploration expenses	900,000	
First two appraisal wells expenditure	900,000	
Customs duties ones sentialeqpt	450,000	
Royalty on oil exported	7,500,000	
Royalty on Local sales of oil	500,000	
Non-productive rental onshore	180,000	
Terminal expenses	200,000	
Commission paid to CBN on tax payments10,000		

Off shore concession rentals	200,000	
Education tax (w1)	2,805,098	(25,445,098)
Adjusted profit	140,254,902	
Deduct losses b/f		250,000
Assessable profit		140,004,902
Deduct: Capital allowance (w2)		1,170,000
Chargeable profit		138,834,902
Chargeable tax @ 85%		₦118,009,666

Workings

i) Education tax

Allowable expenses (Total Income - before charging education tax - Losses b/f) x 2/102

i.e. ₦165,700,000 - 22,640,000-250,000) x 2/102

= ₦2,805,098

=========

2) Capital allowance

	₦
Lower of:	
Capital allowance b/f	-
Annual allowance	1,000,000
Balancing allowance	50,000
Petroleum Investment allowance	120,000
(i)	₦1,170,000
OR	
Restricted to:	
85% of ₦141,480,382	120,258,333
Deduct 170% of ₦120,00	204,000
	₦120,054,333
(ii) Therefore Capital allowance:	₦1,170,000

3) (i) Adelab Oil (Nig) ltd.

Computation of adjusted posted price of crude oil exported for 2014 tax year

	₦
At 350, Posted Price is	20.55
At 30o, Posted Price is ₦20.55 - (5 x11k) i.e.	0.55
:. Adjusted Posted Price =	20.00
	=====

Crude oil lifting for 2000 tax year;

4000 barrels per dayx366days = 1,464,000 barrels

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Export: 95%	1,390,800 barrels
	===========
Domestic; 5%	73,200 barrels
	=============

Therefore, the adjusted posted price of crude oil exported is:

1,390,800 barrels x ₦20 = ₦27,816,000

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Adelab Oil (Nig.) Ltd. Computation of chargeable tax for 2014 tax year

	₦	₦
Value of crude oil exported	27,816,000	
Value of crude oil-domestic		1,095,000
Fiscal value of crude oil sold	28,911,000	
Incidental Income - Balancing charge		15,000
Total income		28,926,000
Deduct:		
Production cost	584,000	
Transportation cost	1,500,000	
Salaries	500,000	
General overhead	70,000	
Bank charges interest	75,000	
Interest on loan from subsidiary	160,000	
Royalties on producing rentals	6,208,000	
Royalties on domestic sales	292,000	
Harbour dues	24,000	
Intangible drilling expense	1,500,000	
Non producing rentals	60,000	
Customs duties	30,000	
Education tax (wi)	351,431	11,354,431
ii) Assessable Profit		17,571,569
Deduct		
Capital allowance (wii)	2,150,000	
iii) Chargeable petroleum profit		15,421,569
iv) Assessable petroleum tax at 85% of chargeable profit		₦13,108,333
v) Chargeable Tax		
Assessable petroleum tax		13,108,333
Deduct		
Investment tax credit at 50% of chargeable profit; (50/100x ₦15,421,569)	7,710,785	
Chargeable tax	5,397,549	
Shared between;		
NNPC @ 30%		

	₦1,619,265
Gboye Oil Nig. Ltd At 70%	
	₦3,778,284
	5,397,549
	========

Workings

i) Education tax:

₦ [28,926,000 - 11,003,000] x 2.
102 = ₦354,431
========

ii) Capital allowance

iii) Lower of;

	₦
Capital allowance b/f	250,000
Annual allowance	1,700,000
P/A	2,150,000
	200,000
AND:	
85%of₦1751569	14,935,834
Deduct 170% of PIA	340,000
	14,595,834
	========
Therefore, capital allowance =	₦2,150,000

29

Minning Taxation

Contents

Mining taxation

29.0 Purpose

At the end of this chapter, students are expected to know:

- The administration procedure of mining business in Nigeria;
- The incentives available for mining operation in Nigeria;
- The minerals titles;
- The environmental considerations and rights of host communities;
- The offences and penalties;
- The computation of capital allowances;
- The process of computing total profits;
- The treatment of losses; and
- The scope and administration of the Nigeria Extractive Industries; and Transparency Initiative (NEITI).

29.1 Administration of the Nigerian minerals

The administrative structure and functions of principal stakeholders are as below:

29.1.1 Functions of the minister

Subject to the provision of the mining Act, the Minister shall:

(a) Ensure the orderly and sustainable development of Nigeria's mineral resources;

(b) Develop a well-planned and coherent programme of exploitation of mineral resources taking into account the economic development, ecological and environmental factors;

(c) Monitor compliance with community development agreements by industry operators;

(d) Establish the procedure for monitoring developments in the solid minerals sector and encourage the private sector investment in mineral resources development;

(e) Ensure that in the exploitation of the mineral resources, an equitable balance is maintained between foreign and indigenous interest;

(f) Create an enabling environment for the private investors, both foreign and domestic by providing adequate infrastructure for mining activities, and identify areas where government intervention is desirable in achieving policy goals and proper perspective in mineral resources development;

(g) Accelerate the development of technical and professional manpower required in the mineral sector;

(h) Establish environmental procedures and requirements applicable to mining operations;

(i) Maintain liaison between investors and government departments and agencies set up for the purpose of development of mineral resources and allied projects; and collaborate with other ministries and agencies of the Federal Government whose functions relate to the objectives of this Act;

(j) Prescribe measures for the general welfare and safety of workers engaged in mineral resources operations;

(k) Develop a geo-scientific databank, and collate detailed data concerning the identity, quantity of Nigeria's mineral resources;

(l) Assist the private sector in identifying specific mining projects;

(m) Initiate, organise and participate in promotion activities in mineral resources development, such as exhibitions, conferences, seminars and workshops geared towards the stimulation of investments in mineral resources;

(n) Provide and disseminate up to date information on incentives in mineral resources available to investors under this Act;

(o) Register and keep records of all enterprises and companies established and pursuing activities in mineral resources and allied projects;

(p) Cause to be created, such departments and agencies as are necessary for the effective administration of this Act;

(q) Introduce investment-friendly local contents measures for mining projects;

(r) Facilitate the development of indigenous technical and professional manpower required in the mineral resources sector;

(s) Co-operate on behalf of the Federal Government with other governments and international agencies in respect of matters relating to Nigeria's mineral resources;

(t) Do such other things as are reasonably necessary or expedient for the performance of his functions under this Act; and

(u) Have the power to designate a mineral as a radio-active mineral and by radioactive regulations make special provisions for the exploration, exploitation, possession, export or otherwise dealing in the radio-active mineral.

29.1.2 Establishment of the Mining Cadastre Office

(1) There shall be established within six (6) months of the coming into effect of this Act a Mining Cadastre Office with the responsibility for the administration of mineral titles and the maintenance of the cadastral registers.

(2) The Mining Cadastre Office:

(a) shall be a body corporate with perpetual succession and a common seal;

(b) may sue and be sued in its corporate name; and

(c) may acquire, hold and dispose of property, whether movable or immovable.

(3) The Mining Cadastre Office shall be administered by a Director- General who shall be assisted by such officers as shall be required for the efficient functioning of the cadastre system.

(4) In order to fulfill its functions under this Act the Mining Cadastre Office shall operate as the sole agency responsible for the administration of mineral titles.

(5) The Mining Cadastre Office shall in addition to any other functions prescribed by or under this Act perform the following:

(a) consider applications for mineral titles and permits, issue, suspend and upon the written approval of the Minister, revoke any mineral title;

(b) receive and dispose of applications for the transfer, renewal, modification, relinquishment of mineral titles or extension of areas;

(c) maintain a chronological record of all applications for mineral titlein:

(i) a priority book which is to be specifically used to ascertain the priority and registration of applications for exclusive rights on vacant areas;and

(ii) a general registry book which is to be used for all other types of applications where registration of the priority is not required;

(d) undertake such other activities reasonably necessary for the purpose of carrying out its duties and responsibilities under the provisions of this Act.

29.1.3 Central and Zonal Offices of the Mining Cadastre Office

A Central Mining Cadastre Office with exclusive authority and jurisdiction over the whole of the country shall be established in Abuja as the headquarters of the Mining Cadastre Office. The Mining Cadastre Office shall, according to administrative convenience, maintain an appropriate number of Zonal offices.

29.1.4 Mining Cadastre Registers

The Mining Cadastre Office shall open a series of files to be known as Mining Cadastre Office Registers for the purposes of this Act, comprising of:

(a) a register of Reconnaissance Permits;

(b) a register of Exploration Licences;

(c) a register of Mining Leases;

(d) a register of Small-scale Mining Leases;

(e) a register of the Water Use Permits; and

(f) a register of Quarry Leases.

29.1.5 Priority

(1) Where several applications are received on the same area or for overlapping areas from two or more persons on the same business day the application which is first received in the proper form shall be deemed to have priority over the others.

(2) The criteria of first come, first served, as evidenced by registration with the issuing authority according to an established procedure, which in the case of the Mining Cadastre Office shall be registration in the priority register established by this Act, shall be strictly applied by the Mining Cadastre Office in case of competing applications for the same exclusive area.

(3) The Mining Cadastre Office shall provide a receipt to an applicant for mineral title evidencing:

(i) all documents and fees received from the applicant in respect of the application; and

(ii) the date and time of the application.

29.1.6 Competitive bidding

(1) The Minister shall by regulations determine areas wherein an exploration licence and a mining lease shall be granted based on competitive bidding requirements.

(2) The Mining Cadastre Office shall consider competing bids and shall, through an open and transparent method, select the bid which will promote the expeditious and beneficial development of the mineral resources of the area having regard to:

(a) the programme of exploration and mining operations which the applicant proposes to carry out and the commitments as regards expenditure which the applicant is prepared to make;

(b) the financial and technical resources of the applicant; and

(c) the previous experience of the applicant in the conduct of reconnaissance and mining operations.

(3) The successful application shall be treated as an application under section 59 or 65.

29.1.7 Fees payable to the Mining Cadastre Office

The Mining Cadastre Office shall collect:

(a) a fee for processing of applications for mineral titles; and

(b) an annual service fee established at a fixed rate per square cadastral unit for administrative and management services rendered by the Cadastre Office.

29.1.8 Revocation of mineral title for failure to pay fees

A mineral title shall become liable to revocation where the holder thereof has failed to pay the prescribed fees.

29.1.9 Process for revocation when mineral titleholder fails to pay fees

In case of default of payment of the annual service fee due to the Mining Cadastre Office, the Mining Cadastre Office shall give a thirty-day written default notice to the defaulting party and, if payment is not effected during that period, the Mining Cadastre Office shall record the default and revoke the mineral title.

29.1.10 Determination of fees payable

The amount of the fees payable under section 10, administration and modalities for their payment shall be determined in the regulations issued by the Minister.

29.1.11 Notice to applicant

Any notice required to be sent by the Mining Cadastre Office to an applicant for, or holder of a mineral title shall be sent by courier service or registered mail to the last known address in Nigeria of the mineral titleholder or given in person to an authorized representative of the applicant or holder of the mineral title in Nigeria or published in the Gazette. The notice shall for all purposes be sufficient notice of the subject-matter of the notice to the applicant for or holder of a mineral title.

29.1.12 Relationship between the Minister and the Mining Cadastre Office (MCO)

In the execution of his functions and relationship with the Mining Cadastre Office, the Minister shall, at all times ensure the independence of the Mining Cadastre Office in regard to the discharge of its functions and operations under this Act.

29.1.13 Establishment of departments

(1) For the purposes of carrying out his functions under this Act, the Minister shall establish in the Ministry:

(a) a Mines Inspectorate Department;

(b) a Mines Environmental Compliance Department; and

(c) such other departments as he may consider expedient for the proper administration of this Act.

(2) Such inspectors, officers and other employees as may be considered necessary or carrying out the objectives of this Act shall be appointed into the departments and agencies established pursuant to subsection (1) of this section.

(3) The powers and duties of the inspectors, officers, or other employees appointed under subsection (1) of this section shall be those assigned to them respectively under this Act, its regulations and in accordance with the provisions of the Public Service Rules in force.

29.1.14 Functions of the Mines Inspectorate Department

The Mines Inspectorate Department shall in addition to any other functions prescribed by this Act and subject to the direction of the Minister:

(a) exercise general supervision over all reconnaissance, exploration and mining operations to ensure their compliance with this Act;

(b) supervise and enforce compliance by mineral titleholders with all mine health and safety regulations prescribed under this Act and any other law inforce;

(c) prepare and render records, reports and returns as required by the Minister or as prescribed by Regulations;

(d) take custody of mineral resources required by any Court to be forfeited to the government;

(e) with the prior approval of the Minister, dispose of any mineral resources forfeited to the government;

(f) carry out investigations and inspections necessary to ensure that all conditions relating to mineral titles and the requirements of this Act are complied with;

(g) discharge such other duties as may be assigned from time to time, by the Minister; and

(h) review and recommend to the Minister, programmes for controlling mining operations.

29.1.15 Functions of the Mines Environmental Compliance department

The Mines Environmental Compliance Department shall in addition to any other function prescribed by this Act and subject to the direction of the Minister:

(a) review all plans, studies and reports required to be prepared by holders of mineral title in respect of their environmental obligations under this Act;

(b) monitor and enforce compliance by holders of mineral title with all environmental requirements and obligations established pursuant to this Act, its regulations and by any other law in force;

(c) periodically audit the environmental requirements and obligations established pursuant to this Act, its regulations and by any other law in force and make recommendations thereon to the Minister; and

(d) liaise with relevant agencies of Government with respect to the social and environmental issues involved in mining operations, mine closure and reclamation of land.

29.1.16 Establishment of State Mineral Resources and Environmental Management Committee

(1) There is hereby established for each State of the Federation a committee to be known as the Mineral Resources and Environmental Management Committee, in this section referred to as "the Committee".

(2) The Committee in each state shall consist of:

(a) a representative of the Mines Environmental Compliance Department in the Ministry who shall be the chairman of the Committee;

(b) a representative of the Ministry responsible for land matters or mineral related matters in the state;

(c) the Mines Officer responsible for the state;

(d) a representative of the Ministry of Agriculture or Forestry in the state;

(e) a representative of the Surveyor-General of the state;

(f) a representative of the Local Government Council when matters affecting the said Local Government Area are being considered by the Committee;

(g) a representative of the State Environmental Department or Agency; and

(h) a representative of the Federal Ministry of Environment in the State.

(3) The functions of the Committee are to:

(a) consider and advise the Minister on issues affecting returns of necessary reports affecting grants of mining titles;

(b) consider issues affecting compensation and make necessary recommendations to the Minister;

(c) discuss, consider and advise the Minister on the matters affecting pollution and degradation of any land on which any mineral is being extracted;

(d) consider such other matters relating to mineral resources development within the State as the Minister may, from time to time, refer to the Committee;

(e) advise the Departments established in accordance with the provisions of this Act for the supervision of mineral exploitation and the implementation of social and environmental protection measures;

(f) advise the Local Government Areas and communities on the implementation of programs for environmental protection and sustainable management of mineral resources;

(g) advice and other necessary assistance required by holders of mineral titles in their interaction with State Governments, Local Government Councils, communities, civil institutions, and other stakeholders;

(h) advise the Minister in resolving conflicts between stakeholders; and

(i) advise the Minister in respect of matters connected with the implementation of this Act.

(4) The Committee shall-

(a) meet at least once every three months and at such times as the Minister may deem necessary; and

(b) regulate its own procedure.

(5) The Chairman shall appoint a competent officer from the Mines Inspectorate Unit in the state to be the secretary of the Committee. The secretary shall have no right to vote at any meeting of the Committee.

(6) The Committee shall forward its report to the Minister after each meeting.

(7) Where the Committee desires to obtain the advice of a host community or any other person on a particular matter, the Committee may co-opt a representative of the relevant host community or any person as a member for such period as it thinks fit, but such a person shall not be entitled to vote in any meeting of the Committee and his attendance shall not count towards a quorum.

(8) The Chairman and three other members shall form a quorum at a meeting of the Committee.

(9) Every meeting of the Committee shall be presided over by the Chairman or, in his absence, by the Mines Officer for the state.

(10) If on any question to be determined there is an equality of votes, the Chairman shall have a casting vote.

(11) The Committee shall have the power to determine its own procedure.

29.1.17 Delegation of powers by the Minister

(1) The Minister may, by notification in the Gazette, delegate to any department or

officer of the Ministry the exercise or performance, subject to such conditions and restrictions as may be prescribed in the notification, of any function conferred on the Minister under this Act provided that it shall not apply to any function of the Minister to make regulations.

(2) An officer authorised in writing by the officer in charge of the Mines Inspectorate Department may enter any mineral title area where mining operations are being carried out under this Act, or which
is within the general area of the mineral title for the purposes of inspecting such operations and he shall be provided by the mineral titleholder with any information reasonably requested for the purpose of making a report.

(3) The failure of the mineral titleholder to provide access to an officer for the purposes of inspection under subsection (2) shall constitute an offence.

29.1.18 Regulations

The Minister shall subject to the provisions of this Act make regulations in respect of any matter required to be prescribed by regulations under this Act and generally for giving full effect to the provisions of this Act, including prescribing, amending or withdrawing any form that may be required under this Act.

29.1.19 Use of land for mining apriority

(1) The use of land for mining operations shall have a priority over other uses of land and be considered for the purposes of access, use and occupation of land for mining operations as constituting an overriding public interest within the meaning of the Land Use Act.

(2) In the event that a mining lease, a small-scale mining lease or a quarry lease is granted over land subject to an existing and valid statutory or customary right of occupancy, the Governor of the State within which such rights are granted shall within sixty days of such grant or declaration revoke such right of occupancy in accordance with the provisions of section 28 of the Land Use Act.

29.2 Mining incentives

The key incentives available to companies engaged in mining operations are summarised below:

According to S.5.2.1 under the Mining Act:

i. Tax holiday for an initial period of 3 years from commencement of operations and renewable for additional 2 years. Any dividend recorded during the tax holiday period will not be subject to withholding tax upon distribution to shareholders;

ii. Exporters of mineral products may be permitted to retain part of their foreign exchange earning in a domiciliary account for the purpose of acquiring spare parts and other mining inputs;

iii. Exemption from customs and import duties in respect of plant, machinery equipment and accessories imported exclusively for mining operations. However, the plant and equipment can only be disposed of locally upon payment of the applicable customs and import duties;

iv. Free transferability of foreign currency through the Central Bank of Nigeria (CBN) for the following:

- Payment for servicing of certified foreign loan; and

- Remittance of foreign capital in event of sale or liquidation of the business.

v. Grant of personal remittance quota for expatriate personnel free from any tax imposed by any enactment for the transfer of external currency out of Nigeria.

vi. Accelerated capital allowance on mining expenditure (95% initial allowance and retention of 5% until asset is disposed);

vii. Grant of investment allowance of 10% on qualifying plant and machinery;

viii. All infrastructure cost provided by the mining company and approved by the MCO to be capitalized and capital allowance claimed at 95% in the first year of operation;

ix. A company may also be entitled to claim an additional rural investment allowance on its infrastructure cost, depending on the location of the company and the type of infrastructure provided;

x. Annual indexation of unutilized capital allowance carried forward by 5% for mines that commenced production within five (5) years from the date of enactment of the Act. Whilst the period for new companies to enjoy this incentive lapsed in 2012, new producers may apply to the Minister of Finance, through the Minister of Mines and Steel Development, to enjoy this incentive. Such application may be considered on a case by case basis;

xi. The Minister may grant a concession for the royalty payable on any mineral to be deferred for a number of years, subject to the approval of the Federal Executive Council; and

xii. Actual amount incurred out of reserves made for environmental protection, mine rehabilitation, reclamation and mine closure cost shall be tax deductible, subject to certification by an independent.

According to the CITA provision;

i. The profits earned by a mining company after the initial tax holiday period may continue to be exempted from income tax under the following circumstances:

- If the minerals are exported from Nigeria, and the proceeds from such exports are repatriated to Nigeria and used exclusively for the purchase of raw materials, plants, equipment and spares;

- If the minerals produced are exclusive inputs for the manufacture of products for exports, provided the exporter gives a certificate of purchase of input to the company; and

- Potential full or partial exemption of interest on foreign loan from income tax, subject to the conditions stipulated under CITA.

ii. Where a mining company records a turnover below ₦1millionwithin the first five years of commencement of business, it will be liable to tax at the rate of 20% on any taxable profit recorded.

Note : With implementation of Finance Act, 2019, where turnover is less than N25m, no tax will be paid. When turnover is N25m and above but less than N100m, tax will be paid at 20%.

iii. Any interest, rent, royalty, or dividend received by a Nigerian company from abroad, and brought into the country through any of the approved Nigerian Banks, will be exempted from corporate income tax.

iv. Interest and/or gains received from bonds issued by any government or corporate body in Nigeria, as well as from short term securities issued by the Federal Government, are exempt from income tax. This exemption is only applicable until 2022 financial year (i.e., 2023 tax year). However, bonds issued by the Federal Government of Nigeria shall continue to enjoy this exemption.

v. The Company may be entitled to the following reliefs:

- Employment tax relief (ETR): To qualify for this relief, the company must have a minimum net employment of 10 employees in an assessment year, out of which 60% must be individuals without prior work experience and have recently graduated from a school or vocation (not older than 3 years). The ETR claimable is limited to the lower of the gross emoluments paid to qualifying employees, or 5% of the assessable profits for the year.

- Work experience acquisition programme relief: Any company with a minimum net employment of five new employees in any year, and where the company has retained the employees for a minimum of two years. This relief exempts from income tax, 5% of the assessable profits.

- Infrastructure tax relief (ITR): This relief is granted to any company that provides infrastructure of a public nature in any assessment year, including power (electricity) roads and bridges, water, health care facilities, educational and sporting facilities. Such company will be entitled to claim tax exemption of 30% of the cost of the public infrastructure provided. The above reliefs are only available until 2017 financial year (i.e., 2018 tax year).

29.3 Minerals titles

A mining title can be granted to an individual, a company or a co- operative. The grant of exploration licence or mining lease could be by competitive bidding or on individual request. In a competitive bid, the government consolidates various mineral locations into blocks, and offer the blocks for sale to all investors with sufficient financial and technical capabilities to carry on mining operations.

According to Sec.46 of the Mining Act:

1. The right to search for or exploit mineral resources is obtained through one of the following mineral titles in the form of:

   (a) a reconnaissance permit;

   (b) an exploration licence;

   (c) a small-scale mining lease;

   (d) a mining lease;

   (e) a quarry lease; and

   (f) a water use permit.

2. Subject to the exceptions provided in this Act, any person that undertakes or is involved in the search for or exploitation of mineral resources without the requisite mineral title or authority shall be guilty of an offence.

3. Any mineral title issued under this Act shall be subject to such conditions as may be prescribed in the licence or lease or by regulation made under this Act.

4. The form of all mineral titles shall be prescribed.

29.4 Possession and purchase of minerals

According to S.92 of the Act "The provisions of this part do not apply to bona fide specimens of mineralogical, geological, or educational interest or-to the receipt by an employer of minerals from his tributers.

According to S.93 "No person, other than an officer of the Ministry authorised in that behalf by the Minister and acting in the execution of his duty shall possess any mineral unless-

(a) the mineral is Won from mineral title area of which the person is the holder and which entitles him to explore and exploit the minerals; or

(b) the person holds a permit to possess or purchase that mineral issued under the provisions of this Act; or

(c) the person is in respect of that mineral within the meaning of regulations made under this Act, a duly authorized agent or employee of any person permitted by paragraphs (a) and (b) of this subsection to possess that mineral".

According to S.94 "No person shall purchase any mineral unless he holds a licence to purchase minerals issued under this Act".

According to S.95 "proceeds recovered under a small scale mining Lease shall be sold to a licensed mineral procurement centre, hereinafter referred to as a "mineral buying centre" and valid, sales receipts obtained and when "mineral buying entre" and valid sales receipts obtained and when centres required shall be produced for inspection by an authorised officer of the Cadastre Office".

According to S.96 (1) The requirements for a buying centre shall be in accordance with this Act. (2) All buying centres, so registered shall be required to keep an up to date record of all purchases and sales of minerals acquired with details as to which mine within the country the minerals were won: and obtained.

29.5 Environmental considerations and rights of host communities

(1) According to S.120 (1) The Environmental Protection and Rehabilitation Programme required under the provisions of the Act shall:

(a) provide for specific rehabilitation and reclamation actions, inspections, annual reports;

(b) a reasonable estimate of the total cost of rehabilitation;

(c) cost estimates for each specific rehabilitation and reclamation action; and

(d) a timetable for the orderly and efficient rehabilitation and reclamation of the Mineral title area to a safe and environmentally sound condition suitable for future economic development or recreational use.

(2) The Mines Environmental Compliance Department shall exercise all its powers in respect of environmental protection and rehabilitation programs provided for in section 119 in consultation with the State Mineral Resources and Environmental Management Committee established pursuant to Section19of this Act.

(3) The Mines Environmental Compliance Department may approve or reject an Environmental Protection and Rehabilitation Program submitted by a Mineral title Holder and shall notify the holder of the mineral title of its decision thereon within sixty days of the submission of the environmental protection and rehabilitation Programme.

(4) If the Mines Environmental Compliance Department does not notify the holder

of a mineral title within the period specified under subsection (3) of this section, the environmental protection and rehabilitation programme shall be deemed to have been approved as submitted.

(5) In the case of a rejection of the environmental protection and rehabilitation programme by the Mines Environmental Compliance Department, the mineral title holder may:

(a) submit such other number of environmental protection and rehabilitation programmes as may be necessary in order to obtain the approval of the Mines Environmental Compliance Department; or

(b) if its application is rejected twice, the holder may submit the matter to arbitration within thirty days of notification of the, decision under subsection (3) of this section.

(6) In the case of its approval, the Mines Environmental Compliance Department shall ensure the implementation of the environmental protection and rehabilitation programme.

29.6 Offences and penalties

1. According to S.131 A person who:

(a) conducts exploration or mines minerals or carries out quarrying operations otherwise than in accordance with the provisions of the Act;

(b) in making application for mineral title, knowingly makes a statement which is false or misleading in any material particular;

(c) in any report, return or affidavit submitted in pursuance of the provisions of this Act, knowingly gives an information which is false or misleading or fails to declare in any material particular; and

(d) removes, possesses or disposes of any mineral contrary to the provisions of this Act commits an offence.

2. According to S.132 (1), No loan granted pursuant to Part III of this Act shall be applied to any loans purpose other than that for which the loan was granted.
3. Any person who applies a loan granted pursuant to Part III of this Act in contravention of subsection (I) of this section commits an offence and is liable on conviction to a fine of an amount not less than the amount of the loan and interest accruing thereof in respect of which the offence was committed or imprisonment for a term of not less than five years.

4. Where an offence under this section is committed by a body corporate is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of any director, manager secretary or other similar

officer of the body corporate (or any person purporting to act in any such capacity}he as well as the body corporate shall be deemed to be guilty of the offence and maybe proceeded against and punished in accordance with subsection (2) above.

According to S.133 A mineral title holder who is guilty of an offence under section 131 is liable to have his licence revoked and on conviction at the first instance, to a fine not less than ₦20,000,000.00; and imprisonment of not less than five years, if the offence is a continuing one, whether or not it is a first offence, the person convicted shall, in addition, be liable to a fine of N20,000.00 in respect of each day during which the offence continues.

According to S.134, A person who:

(a) places or deposits, or causes to be placed or deposited in a place any minerals, with the intention to mislead any other person as to the mineral possibilities of the place; or

(b) mingles or causes to be mingled, with samples or ore, any substances which may enhance the value or in any way change the nature of the ore, with the intention to cheat, deceive or defraud; or engages in the business of milling, leaching, sampling, concentrating, reducing, assaying, transporting, or dealing in ores, metals or minerals, contrary to the provisions of this Act commits an offence under this Act and is liable on conviction to a fine of not less than ₦500 ,000.00 or to imprisonment for a term not exceeding 2 years or to both fine and imprisonment.

According to S.135: A “person who keeps or uses any false or fraudulent scale or weight for weighing ores, metals or minerals, or uses any false or fraudulent assay scale or weight or enriched fluxes used for ascertaining the assay value of minerals, knowing them to be false or fraudulent commits an offence under this Act, and is liable on conviction to a fine of not less than ₦100,000.00 or more than ₦1,000,000 or to imprisonment for a term not less than 1 year or both fine and imprisonment.

According to S.136 (1) A person who falsely represents that he obtained, the grant of an exploration licence, temporary title mining or other mining title and by that representation induces or attempts to induce any person to invest capital in a company or syndicate connected with the company before he actually obtains the grant of the mining title shall forfeit any claim to the grant of the mining title.

5. Where a person who makes a false representation as in subsection (1) of this section is a holder of another mining title, that mining title shall be revoked.

6. Nothing in this section shall be construed as a person who makes a false representation from liability to civil action or a criminal prosecution in respect of the representation.

According to S.137 A person who without lawful authority willfully breaks, defaces or removes or in any other way interferes with any boundary mark, beacon pillar or post erected for any of the purpose of this Act or the regulations made under it without necessary approval or authority under this Act commits an offence.

According to S.138 (l) Any person who without lawful cause;

(a) interferes with or obstructs any mining or quarrying operation authorised by or under this Act; or

(b) interferes with any machinery, plant work or property on, in under or over land in exercise of a right conferred by or under this Act commits an offence.

2. A person who commits an offence under section 137andsubsection

(1) of this section is liable on conviction:

(a) at the first instance, to a fine not exceeding N500,000.00 or imprisonment for a term not exceeding 2 years or both the fine or imprisonment; and

(b) at a second or subsequent offence, to imprisonment for a term not exceeding 5 years or below 2 years.

3. If the offence is continuing one whether or not it is a first offence, the person convicted shall, in addition, be liable' to a fine of ₦10,000.00 in respect of each day or part of a day during which the offence continues.

According to S.139. (1) Where an offence under this Act or under the regulations made there under is committed by a body of persons
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(a) in the case of a body corporate other than a partnership, every director of the body who took part in the management of the body shall, be deemed to be guilty of that offence; and.

(b) in the case for a partnership, every partner or officer of that body shall be deemed to be guilty of that offence.

(2) Nothing in this section shall be construed as exempting any person who actually committed an offence, under this Act from the penalties provided for the offences committed by him.

According to S.l40. (1) Where an offence under this Act has been committed by a body corporate or firm or other association of individuals, a person who at the time the commission of the offence was an officer thereof or was purporting to act in such capacity is severally guilty of that offence and liable to be prosecuted against and punished for the offence in like manner as if he had himself committed the offence, unless he proves that the act or omission constituting the offence took place without his knowledge, consent or connivance.

(2) In this section and the other provisions of this Act, officers:

(a) in relation to a body corporate, includes a director, chief executive, manager and secretary;

(b) in relation to a firm, includes a partner and other officer thereof; and in relation to any other association of individuals, includes a person concerned in the management of the affairs of such association.

According to S.141.-

(1) Any dispute arising between the holder of a mineral title and the Government in respect of the interpretation and application of this Act, its regulations and the terms and conditions of mineral titles shall be resolved, in the first instance, on an amicable basis.

(2) Where the dispute is in the nature of a bona fide investment dispute, and such dispute is not amicably settled as provided under subsection (1) of this section, it shall be resolved in accordance with the provisions of the Nigerian Investment Promotions Commission Act, Cap. N 117 Laws of the Federation of Nigeria, 2004.

(3) Any other dispute between the holder of a mineral title and the Government shall be resolved in the Federal High Court, if not settled in accordance with the provisions of subsection (1) or (2) of this section.

According to S.142; An offence under this Act and the regulations made under it shall be tried by the Federal High Court.

29.7 Allowable and disallowable expenses

All direct cost of mining and transportation are all allowable expenses.

All allowable expenses as we have under CITA for corporate mining company

All allowable expenses as we have under PITA for individuals into mining business

29.8 Rates of capital allowances

Summary of capital allowances for a mining company is provided below:

Description	**Initial Allow %**		**Annual Allow %**	
	Company	Individual	Company	Individual
Mining expenditure	95	20	0	10
Furniture and fitting	25	15	20	10
Motor vehicle	50	25	25	20
Building and leasehold (not industrial buildings)	15	5	10	10

29.9 Computation of capital allowances

Accelerated capital allowance of 95% is granted on the under listed qualifying mining capital expenditure incurred in the year in which the investment is incurred:

(a) all certified exploration, development and processing expenditure, including feasibility study and sample assaying costs; and

(b) all infrastructure costs incurred regardless of ownership and replacement.

(Note that the procedure for commencement of business and for existing businesses is the same as we have under the CITA).

Illustration
The tax written down value of qualifying capital expenditure for Olowogbowo Mining Limited for year ended 31/12/2016 are as stated below:

S/N	QCE	TWDV	(₦)	Remarks
1.	Mining expenditure	195,000		3rd year of use
2.	Furniture and fitting	860,000		2 years remaining
3.	Motor vehicle	3.2m		3 years remaining

Additional information

1. On 1/4/2017 ₦7m mining expenditure was incurred
2. On 1/10/2017 furniture costing ₦900,000 was acquired

Required
Compute capital allowance for 2017 and 2018 tax year

Suggested solution to illustration

	Mining expenditure	Furniture and fitting	Motor vehicle	Capital allowance
IA (%)	95	25	50	
AA (%)	0	20	25	
	₦	₦	₦	₦
2017 (1/1/16 – 31/12/16)				
TWDV	195,000	860,000	3, 200,000	
AA	-	430,000	1,066,667	1,496,667
CA				1,496,667
2018 (1/1/17 – 31/12/17)				
TWDV	195,000	430,000	2,133,333	
Cost	7,000,000	900,000	-	
IA	6,650,000	225,000	-	6,875,000
AA	-	564,990	1,066,667	1,631,657
CA				8,506,657
TWDV/NV	545,000	540,010	1,066,667	

29.10 Total profits

The concept of total profits is as stated under CITA. It is the process of assessing limited liability companies to tax. It involves computation of adjusted profit, loss relief and Capital Allowance. Company Income Tax is computed on total profit and Education tax on assessable profit as stated earlier.

29.11 Treatment of losses

Under the Act, losses incurred in a year of assessment can be carried forward and set-off against the assessable profits of the subsequent tax years (if any).

29.12 Scope and administration of the Nigeria Extractive Industries Transparency Initiative (NEITI) Act No 17, 2007

The detailed administrative structure is as stated under sub-heads below;

22.12.1 Establishment of the national stakeholders working group

(1) The governing body of the NEITI shall be the National stakeholders working group (in this Act referred to as "the NSWG").

(2) The NSWG shall be responsible for the formulation of policies, programmes and strategies for the effective implementation of the objectives and the discharge of the functions of the NEITI.

(3) Without prejudice to subsection (2) of this section, the NSWG shall have powers to recommend the annual budget and work-plan of the NEITI and ensure the periodic review of programmes performance by the NEITI.

22.12.2 Composition of the NSWG

(1) The NSWG shall be constituted by the President and shall consist of a chairman and no more than 14 other members, one of whom shall be an Executive Secretary.

(2) (a) In making appointment into the NSWG, the President shall include:

(i) representative of extractive industry companies;

(ii) representative of civil society;

(iii) representative of labour unions in the extractive industries;

(iv) experts in the extractive industry; and

(v) one member from each of the six geo-political zones.

(b) The Chairman and other members of NSWG other than the Executive Secretary shall serve on part-time basis.

(3) The appointment of Executive Secretary shall be for 5 years and no more.

22.12.3 Tenure of Office of NSWG

A person appointed as a member of the NSWG shall hold Office for 4 years and no more.

22.12.4 Payment of the allowances to the NSWG

The members of the NSWG as well as any person appointed to any of its special committees under section 2 may be paid such allowances out of the funds of the NEITI as the National Revenue Mobilisation and Fiscal Commission may approve.

22.12.5 Meetings of the NSWG

(1) The NSWG shall ordinarily meet quarterly for the dispatch of business at such times and places as it may determine, but not less than four times in a year.

(2) At every meeting of the NSWG, the Chairman shall preside and, in his absence, a member of the NSWG appointed by the members from among themselves shall preside.

(3) Questions proposed at a meeting of NSWG shall be determined by a simple majority of members present and voting and in the event of an equality of votes, the person presiding shall have a casting vote.

(4) The NSWG may at any time co-opt any person to act as an adviser at any of its meetings but no person so co-opted shall be entitled to vote at any meeting.

(5) The validity of the proceedings of the NSWG shall not be affected by the absence of any member, vacancy among its membership or by any defect in the appointment of any of the members.

22.12.6 Quorum

The quorum of the NSWG at any meeting shall be 8 members.

22.12.7 Special committees

The NSWG may constitute such special committees as it considers fit to deal different aspects of its responsibilities.

22.12.8 Appointment of Executive Secretary, consultants and other staff of the NSWG

(1) The NSWG may create departments and engage the services of such staff and consultants as it may consider necessary for the NEITI.

(2) The NEITI shall have an Executive Secretary who shall-

(a) be appointed by the President upon the recommendation of the NSWG provided he is a graduate with relevant qualifications and at least 10 years cognate experience;

(b) be responsible for the day to day administration of the NEITI; and

(c) serve as Secretary to NSWG.

(3) The staff and consultants of the NEITI may be engaged on such terms and conditions as the NSWG may determine.

(4) The NSWG shall fix the remunerations, allowances and benefits of the staff and consultants of the NEITI.

(5) (a) The NSWG shall recommend to the President for appointment, qualified validators in line with NEITI guidelines as contained in second schedule to this Act; and

(b) NSWG shall fix the remunerations, allowances and benefits for the validators.

29.13 Chapter review

Basically, this topic is relatively new as the emphasis on it has just been giving preference. The candidate, after studying this chapter is expected to appreciate the administrative procedure to go into mining, the incentives available, list of mineral titles, environmental considerations, process of tax computation, the peculiar capital allowance computation and the Nigeria extractive industries transparency initiative (NEITI).

29.14 Worked examples

29.14.1 Open-ended questions

1. List the incentives available for mining operation in Nigeria.

2. What are the environmental considerations and rights of host communities?

3 Discuss the composition and tenure of office of the National Stakeholders Working Group [NSWG]

29.14.2 Suggested solutions to open-ended questions

Question 1

The key incentives available to companies engaged in mining operations, according section 5 subsections 2.1 of the Minning Act are summarised below:

(a) Tax holiday for an initial period of 3 years from commencement of operations and renewable for additional 2 years. Any dividend recorded during the tax holiday period will not be subject to withholding tax upon distribution to shareholders;

(b) Exporters of mineral products may be permitted to retain part of their foreign exchange earning in a domiciliary account for the purpose of acquiring spare parts and other mining inputs;

(c) Exemption from customs and import duties in respect of plant, machinery equipment and accessories imported exclusively for mining operations. However, the plant and equipment can only be disposed of locally upon payment of the applicable customs and import duties;

(d) Free transferability of foreign currency through the Central Bank of Nigeria (CBN) for the following:

i. Payment for servicing of certified foreign loan; and

ii. Remittance of foreign capital in event of sale or liquidation of the business.

(e) Grant of personal remittance quota for expatriate personnel free from any tax imposed by any enactment for the transfer of external currency out of Nigeria;

(f) Accelerated capital allowance on mining expenditure (95% initial allowance and retention of 5% until asset is disposed);

(g) Grant of investment allowance of 10% on qualifying plant and machinery;

(h) All infrastructure cost provided by the mining company and approved by the MCO to be capitalised and capital allowance claimed at 95% in the first year of operation;

(i) A company may also be entitled to claim an additional rural investment allowance on its infrastructure cost, depending on the location of the company and the type of infrastructure provided;

(j) Annual indexation of unutilised capital allowance carried forward by 5% for mines that commenced production within five (5) years from the date of enactment of the Act. Whilst the period for new companies to enjoy this incentive lapsed in 2012, new producers may apply to the Minister of Finance, through the Minister of Mines and Steel Development, to enjoy this incentive. Such application may be considered on a case by case basis;

(k) The Minister may grant a concession for the royalty payable on any mineral to be deferred for a number of years, subject to the approval of the Federal Executive Council; and

(l) Actual amount incurred out of reserves made for environmental protection, mine rehabilitation, reclamation and mine closure cost shall be tax deductible, subject to certification by an independent.

2. **Environmental considerations and rights of host communities**

a. According to S.120 (1),the environmental protection and rehabilitation program required under the provisions of the Act includes:

(i) provision for specific rehabilitation and reclamation actions, inspections, and annual reports;

(ii) a reasonable estimate of the total cost of rehabilitation;

(iii) cost estimates for each specific rehabilitation and reclamation action; and

(iv) a timetable for the orderly and efficient rehabilitation and reclamation of the Mineral title area to a safe and environmentally sound condition suitable for future economic development or recreational use.

b. The Mines Environmental Compliance Department shall exercise all its powers in respect of environmental protection and rehabilitation programmes provided for insection119 in consultation with the State Mineral Resources and Environmental Management Committee established pursuant to section 19 of this Act;

c. The Mines Environmental Compliance Department may approve or reject an environmental protection and rehabilitation program submitted by a mineral title holder and shall notify the holder of the mineral title of its decision thereon within sixty days of the submission of the environmental protection and rehabilitation programme;

d. If the Mines Environmental Compliance Department does not notify the holder of a mineral title within the period specified under subsection (3) of this section, the environmental protection and rehabilitation programme shall be deemed to have been approved as submitted.

e. In the case of a rejection of the environmental protection and rehabilitation programme by the Mines Environmental Compliance Department, the mineral title holder may:

(i) submit such other number of environmental protection and rehabilitation programmes as may be necessary in order to obtain the approval of the Mines Environmental Compliance Department; or

(ii) if its application is rejected twice, the holder may submit the matter to arbitration within thirty days of notification of the decision, under subsection (3) of this section; and

f. In the case of its approval, the Mines Environmental Compliance Department shall ensure the implementation of the environmental protection and rehabilitation programme.

3. **Composition of the NSWG**

The NSWG shall be constituted by the President and shall consist of a chairman and no more than 14 other members, one of whom shall be an Executive Secretary.

(a) In making appointment into the NSWG, the President shall include:

(i) representative of extractive industry companies;

(ii) representative of civil society;

(iii) representative of labour unions in the extractive industries;

(iv) experts in the extractive industry; and

(v) one member from each of the six geo-political zones.

(b) The Chairman and other members of NSWG other than the Executive Secretary shall serve on part-time basis.

The appointment of Executive Secretary shall be for 5 years and no more.

Tenure of Office of NSWG

A person appointed as a member of the NSWG shall hold Office for 4 years and no more.

Payment of the allowances to the NSWG

The members of the NSWG as well as any person appointed to any of its special committees under section 2 may be paid such allowances out of the funds of the NEITI as the National Revenue Mobilisation and Fiscal Commission may approve.

Professional level

Advanced Taxation

30

Interpretation of tax laws

Contents

30.0 Purpose

After studying this chapter, readers should be able to:

(a) interpret tax laws, using decided cases; and

(b) know the principles on which decided cases are based.

30.1 Introduction

In the interpretation of taxing statutes, there are principles on which
the interpretation of a particular statute is done by the courts and legal practitioners and tax experts are expected to have the knowledge in order to understand the statutes and their implications.

These fundamental principles guide the judges in interpreting the laws and also in arriving at their decisions. L.J Denning in Seafood Court Estates v Asher (1949) 2 All ER 155 had this to say:

"A judge must not alter the material of which the Act is woven but he can and should iron out the creases. When a defect appears, a judge cannot simply fold his hands and blame the draftsman. He must set to work on the constructive task of finding the intention of the Parliament and then he must supplement the written words so as to give force and life to the intention of the legislature.

Also in FCT v Westraders Barwick CJ said: "It is for the parliament to specify and to do so, in my own opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax." The function of the court is to interprete and apply the language in which Parliament has specified in those circumstances. The court is to do so by determining the meaning of the words employed by the Parliament according to the intention of the Parliament, which is discoverable from the language used by the Parliament. It is not for the court to mould or attempt to mould the language.

Barwick to a strict literal approach to interpreting taxation legislation. Barwick approach were that taxes were penalties imposed by the state, which stood between citizens and their right to prosper from their enterprise. The tax laws could be construed in highly technical terms, without regard for the purpose they were designed to serve.

Justice Graham hills of the Australian High Court, his views as to the correct approach for a court to take in interpreting taxation legislation, made it clear that a court should adopt a purposive approach by applying the ordinary meanings of the words used to give effect to the legislative purpose behind the legislation. This approach requires looking to the context of the legislation in its widest sense to give effect to the objects of the legislation. However, such approach not be used to advance any personal theories of justice.

30.1.1 Cardinal rules for interpretation of taxing statutes

30.1.2 Rule of literal interpretation

This principle is based on the fact that if the language of the statute is clear and unambiguous, Courts must give words their ordinary meaning. Courts have no authority to place a different construction on it, even if it leads to an injustice, it must apply it according to its terms as pronounced in CIT VS T. V Sndaram Iyyengar (1975).

(a) **CIT vs Elphinstone Spg & Wvg Mills Co. Ltd.** 40 ITR 142 (SC) and CIT vs Motors & General Stores Ltd. 66 ITR 692, 699-700 (SC)No tax can be imposed on the subject without words in the Act clearly showing an intention to lay a burden upon him. In other words, the subject cannot be taxed unless he comes within the letter of the law. The argument that he falls within the spirit of the law cannot be available by the Department.

(b) **City of Jesup vs. Bennett. 226. Ga.606(1970)**

Where the language of an act is plain and unequivocal, judicial construction is not only unnecessary but is forbidden.

(c) Rowlatt J. in **Cape Brandy Syndicate vs IRC** (1921) 1 KB 64 approved in **CIT vs Ajax Products Ltd.** (1965) 55 ITR 741 (SC).“In a taxing Act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look at the language used.” (p.747).

Thus, when the language of a taxing statute is clear, if an assesses falls within the four corners of the statute, he is to be taxed; if not, no tax is to be levied.

(d) **Smt. Tarulata Shyam vs. CIT** (1971) 108 ITR 345 (SC). There is no scope for importing into the statute words which are not there. Such importation would be, not to construe, but to amend the statute. Even if there be a casus omiss us, the defect can be remedied only by Legislation and not by judicial interpretation.

30.1.3 Golden rule (Doctrine of purposive construction)

If the strict interpretation of the taxing statute is likely to lead to a manifest absurdity, then the golden rule of construction implies that the meaning of the words should be so effected that such an absurdity is avoided. The application of this rule is rather limited in the realm of construction of taxing statutes, since the literal rule would gain precedence over the golden rule and it is often remarked that equity and taxation are strangers – **Grey vs. Pearson** (1857) 6 HL 61, 106.

30.1.4 Rule of harmonious construction

When any provision of a taxing statute is interpreted, it must be so constructed that the meaning of such provision must harmonise with the intention of the Legislature behind the provision in particular and the enactment in general – CIT vs. Chandanben Maganlal (2002) 120Taxman 38 (Guj.). However, this would always be subject to the fact that the particular provision, or even the entire enactment, should not be held unconstitutional.

30.1.5 Doctrine of ‘reading down’

Resort to reading down is done where a legal provision; read literally, seems to offend the Constitutional provisions concerning fundamental rights or is found to be outside the competence of the particular Legislature. Some relevant decisions are given hereunder.

(a) **Sri Venkateshwara Timber Depot vs. Union of India** (1991) 189 ITR 741/155 Taxman 308 (Ori). The Court construes the provision in question in a limited sense to ensure that its meaning falls within the parameters of constitutionality or is intra vires the powers of the Legislature in question (generally in the case of State Legislatures).

(b) **Arun Kumar vs. UOI** (2006) 155 Taxman 659 (SC) Reading down a provision is based on the premise that to sustain the law by interpretation is the rule. To add further, as held in **Kedar Nath Singh vs. State of Bihar AIR** 1962 SC955.

“The Legislature is presumed to be aware of its limitations and is also attributed an intention not to overstep its limits.”

30.1.6 Rule of beneficial construction

In cases where there are two interpretations possible, the one which is beneficial to the assessee would be preferred. This principle was laid down in a landmark judgment in

IRC vs. Duke of West minister 1936 AC 1 wherein Tomlin LJ stated that an assessee may arrange his affairs within the bounds if the law so as to minimize the incidence of tax.

(a) **McDowell & Co. Ltd. Vs. CTO** (1985) 154 ITR 148 (SC). The Apex Court clamped down on the liberal construction and the pendulum swung to the other extreme, as the Court made fine distinctions between tax evasion, tax avoidance and tax planning and virtually rendered the Westminister Principle nugatory. Here, the Court followed the interpretation that the letter and spirit of the law must be followed. In this post-McDowell era, the department generally got favourable verdicts and a lot of assesses suffered due to the Courts coming down heavily on tax avoidance measures, which were equated with tax evasion.

(b) **UOI vs. Azadi Bachao Andolan** (2003) 263 ITR 707 (SC) The case dealt with conflicts between the Indo-Mauritious Double Tax Avoidance Agreement and the Income Tax Act, 1961, it was held that an assessee was entitled to arrange his affairs so as to minimize the incidence tax, thus, partly confirming the West minister Principle.

30.1.7 Charging sections to be strictly construed while benevolent and procedural sections should be liberally construed

This is a very important and practical rule of interpretation and generally resorted to while interpreting the sections pertaining to incentives, exemptions and deductions where the spirit is to promote exports, increase earnings in foreign convertible exchange, promote industrialization, infrastructure development etc. A provision for appeal should also be liberally construed.

(a) **CIT vs. Naga Hills Tea Co. Ltd.** 89 ITR 236, 240(SC);
CIT vs. Contr ED vs. Kanakasabai 89 ITR 251, 257 (SC)

A provision for exemption or relief should be construed liberally and in favour of the assessee even if it results in his obtaining “a double advantage”.

(b) **Gursahai Saigal vs. CIT** 48 ITR (SC)1
Those sections which impose the charge or levy should be strictly construed; but those which deal merely with the machinery of assessment and collection should not be subjected to a rigorous construction but should be construed in a way that makes the machinery workable.

(c) **Bajaj Tempo Ltd.** 196 ITR 188 (SC)
A provision in a taxing statute granting incentives for promoting growth and development should be construed liberally, and since as provision for promoting economic growth has to be interpreted liberally, the restriction on it too has to be construed so as to advance the objective of the provision and not to frustrate it. While interpreting the various provisions, the Court must not adopt a hyper technical approach and apply cut and dry formula. A pragmatic approach should be adopted so that the object of the introduction/ insertion of a particular provision could be achieved

(Similar views have been expressed in Juggilal Kamlapat vs. CIT (1969) 73 ITR 702 (SC), CIT vs. Strawboard Manufacturing Co. Ltd. (1989) 177 ITR 431 (SC) at page 434 and CIT vs. South Arcot District Co-operative Marketing Society Ltd. 176 ITR 117 (SC) at page 119].

(d) **CIT vs. Poddar Cement (P.) Ltd.** [1997] 226 ITR 625 (SC)
Where there are two possible interpretations of a particular section which is akin to a

charging section, the interpretation which is favourable to the assessee should be preferred while construing that particular provision. Reiterating the same view, in the case of CIT vs. Shaan Finance (P.) Ltd. [1998] 231 ITR 308 (SC) it has been held that in interpreting a fiscal statute, the Court cannot proceed to make good the deficiencies if there be any. The Court must interpret the statute as it stands and in case of doubt, in a manner favourable to the tax payer.

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(e) **CIT vs. Vegetable Products Ltd** [1973] 88 ITR192
It has been held that if the Court finds that the language of taxing provision is ambiguous or capable of more meaning than one, then the Court has to adopt the interpretation which favours the assessee.

(f) **Gannon Dunkerly & Co. Ltd. vs. CBDT** 159 ITR 162 (Bom.) The object of section 80-O is to encourage the export of Indian Technical Knowhow and augmentation of foreign exchange resources of the country and hence a superficial and narrow interpretation can only defeat the benevolent purpose behind the provision of section80-O.

30.1.8 Mischief rule (Heydon's case 1584) .3 Co. Rep.7a,7b

This rule is one of the canons of statutory interpretation and its basis lies in the four aspects outlined below:

(a) What was the common law prior to the enactment of the statute?

(b) What was the defect or mischief which the common law failed to rectify?

(c) What remedy did the Legislature provide by way of the statute enacted?

(d) What was the legislative intent behind such remedy?

The application of the mischief rule would generally be done very rarely in taxing statutes, since a Court would have to exhaust all the other modes and aids to interpretation before applying the 'mischief rule'.

30.1.9 Construction of penal provisions

There are several penal provisions in taxation statutes and these have special rules of interpretation and notable among these are:

(a) Strict construction

(b) Prospective in operation and not retrospective; thus, any act which is currently not an offence cannot be made one retrospectively by amendment of a penal provision with retrospective effect;

(c) presumption of mensrea (i.e., guilty intention to commit the crime)
unless the statute specifically provides for the absence of the same.

To illustrate, concealment of income may be presumed by the department (without mens rea) and the onus of proof lies on the assessee to show that there is no concealment.

i. **Jarnail Singh vs. ITO** [1989] 179 ITR 426 (P&H); **CITvs. Gangaram Chapolia** [1976] 103 ITR 613(Ori.) (FB).

To bring an act under the provisions of section 276C, the action of the person concerned has to be a wilful attempt to evade any tax, penalty or interest chargeable or imposable under the Act. The word 'wilful' imparts the concept of mensrea, and if mensrea is absent, no offence under this section is made out.

30.1.10 Rule of 'Ejusdem Generis' or Noscitur a Sociis

The Rule is that the meaning of a general word is restricted by the special words appearing along with it. To illustrate:

Gore vs. State .79 Ga. App: 669 (1949)

When a statute includes general terms, following specific terms, the general terms are confined to the same kind as the specific term.
"If a man tells his wife to go to the market to buy vegetables, fruits, groceries and anything else she needs, the 'anything else' would be taken to mean food and grocery items due to the rule of ejusdem generis and not cosmetics or other feminine accessories."

Thus, the meaning of a word must be taken by the company it keeps (Rule of noscitur a sociis). In the case of CIT vs. Raj Kumar [2009] 181 Taxman 155 (Del.) regarding Deemed dividend under section 2(22)(e) of the Income-tax Act, 1961, the word 'advance', which appears in company of word 'loan' was interpreted. Section 2(22)(e) reads as "any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) [made after the 31 May 1987, by way of advance or loan to a shareholder, …….]

It was held that advance can only mean such advance which carries with it an obligation of repayment. A trade advance, which is in nature of money transacted to give effect to a commercial transaction, cannot be treated as 'deemed dividend' falling within ambit of provisions of section 2(22)(e). Rule of noscitur a sociis was applied.

30.1.11 Rule of 'Expressio Unius Est Exclusio Alterius' (Expression of one thing implies Exclusion of other Similar Things)

This rule means that where there are two mutually exclusive items, the inclusion of one would implicitly mean the exclusion of the other.

The above rules are the most basic rules of interpretation and the Courts use them along with certain Acts like the General Clauses Act, 1897and the State General Clauses Act, to ascertain meanings of words not defined in the Act.

Roman vs. Terrell, 195 Ga. App.219 (1990)

When one thing is included in a statute, similar things not mentioned in the statute are deemed to be excluded.

Bailey vs. Lumpkin, 1 Ga.392, 403, 404 (1846)

If same things (of many) are expressly mentioned, the inference is stronger that those omitted are intended to be excluded than if none at all had been mentioned.

30.1.12 External aids to interpretation

The Court may also use certain external aids like works of prominent authors, dictionaries, legislative debates, etc., to interpret a statute correctly. Relevance of Finance Minister's speech to interpret tax statutes: The words of the statute do themselves best declare the intention of the law given. It is only if there is any ambiguity in the language, in understanding the intention of the Legislature that the aid can be taken of the proceedings in the Parliament including the aims and objects of the Act. Section 57 of the Evidence Act not only enables but enjoins the duty upon the Courts to take judicial notice of the course of proceedings in the Parliament.

30.1.13 Generalia Specialibus Non Derogant: (General provisions must yield to the special provision)

Generally speaking, the sections in the Act do not overlap one another and each section deals only with the matter specified therein and goes no further. If a case appears to be governed by either of two provisions, it is clearly the right of the assessee to claim that he should be assessed under the one, which leaves him with a lighter burden.

The literal meaning of the expression 'Generalia Specialibus Non Derogant' is that general words or things do not derogate from the special. The Courts have held the expression to mean that when there is a conflict between a general and special provision, the latter shall prevail as held in the cases of CIT vs. Shahzada Nand and Sons 60 ITR 392 (SC) and UOI vs. Indian Fisheries (P.) Ltd. AIR 1966 SC 35, or the general provisions must yield to the special provision.

Where there is a conflict between two statutes:
The general rule to be followed in case of a conflict between two statutes is that a later statute abrogates the earlier ('leges posteriors priores contrarias abrogant') and the well-known exception is that general legislations do not derogate special legislations.

Partnership Act vs. Income Tax Act: The above maxim was applied when the questions relating to assessments of a firm and its partners arose under the Income-tax Act, 1961 where the dissolution of the firm and its succession was held to be governed by the Special Act viz., the Income-tax Act and not the Partnership Act. The Karnataka High Court has held in the case of **CIT vs. Shambulal Nathalal & Co.** [1984] 145 ITR 329 (Kar.) that when the Legislature has deliberately made a specific provision to cover a particular situation, for the purpose of making an assessment of a firm under the Income-tax Act, there is no scope for importing the concept and the provisions of the Partnership Act. The legal position of a firm under the income-tax law is different from that under the general law of partnership in several respects.

Claim as Donation u/s 80G or Business Expenses u/s 37(1): In **Jaswant Trading Co. vs. CIT** 212 ITR 24 (Raj): 128 CTR 306: 85 Taxman 639 (Raj.) the Rajasthan High Court held that the provisions of section 37 are general in nature and the provisions of section 80G are specific. Applying the maxim generalia specialibus non derogant if an amount is liable for deduction under section 80G it cannot be claimed under the general provisions of section 37(1).

30.1.14 Mimansa Rules of Interpretation

If there are two possible interpretations of a rule, one which serves the object of a provision in the parent statute and the other, which does not, the former has to be adopted because adopting the latter will make the rule ultra vires the Act. (b) The Act falls in the second layer in this hierarchy, the rules made under the Act fall in the third layer. Hence, if there is any conflict between the provisions of the Act and the provisions of the Rules, the former will prevail.

Rules and notification – Rules made under the Act have the same force as the sections in the Act. But no exercise of the rule-making power can affect control or detract from the full operative effect of the provisions of the sections. Any rule, which purports to do so, would be ultra vires and void. - Hukumchand Mills Ltd vs. State of MP 52 ITR 583, 589(SC).

30.1.15 Miscellaneous

(a) Definition clause – In **CIT vs. The Hindu** 18 ITR 237, 250; **CIT vs. Srinivasan & Gopalan** 23 ITR 87 (SC) it was held that a definition or interpretation clause, which extends the meaning of a word, should not be construed as taking away its ordinary meaning. Further, such a clause should be so interpreted as not to destroy the basic concept or essential meaning of the expression defined, unless there are compelling words to the contrary.

(b) **Undefined words** – Words, which are not specifically defined, must be taken in their legal sense or their dictionary meaning or their popular or commercial sense as distinct from their scientific or technical meaning, unless a contrary intention appears.

(c) **Legal fiction** – In **CIT vs. Godavari Sugar Mills Ltd** 63 ITR 310, 315-6 (SC) it was held that the word "deemed" is apt to include the obvious, the uncertain and the impossible. A legal fiction has to be carried to its logical conclusion. However, in **CIT vs. Vadilal Lallubhai** 86 ITR 2, 8 (SC) it was held that the fiction operates only within the field of the definite purpose for which the fiction is created.

(d) **Marginal notes** – Marginal notes to the sections cannot control the construction of the statute – **CIT vs. Ahmedbhai Umarbhai** 18ITR 472, 487 (SC); **Chandroji Rao vs. CIT** 77 ITR 743, 745-6 (SC)], but they may throw light on the intention of the legislature – **CIT vs. Vadilal Lallubhai** 86 ITR 2,11 (SC).

(e). **Punctuation** – Punctuation may assist in arriving at the correct construction of a statutory provision.

(f) **Retrospective effect of rules and notifications** – An authority cannot make rules or issue notifications adversely affecting the assessee's rights with retrospective effect, unless the statute, whether expressly or by necessary intendment, empowers the authority to do so – **ITO vs. Ponnoose** [1970] 75 ITR 174 (SC). This principle received statutory recognition in section 295(4) w.e.f. 18.8.1974 inserted by Direct Taxes (Amendment) Act,1974.

(g) **A completed assessment may be reopened or rectified** – A completed assessment may be reopened u/s 147 or rectified u/s 154 – **Venkatachalam vs. Bombay Dyeing & Manufacturing Co Ltd.** 34 ITR 143 (SC), if the relevant provisions of the law are amended with appropriate retrospective effect.

(h) **Necessity of speaking orders** - Where under the provisions of the Act an authority is empowered to grant approval or exemption, and the taxpayer has a right to claim it on fulfillment of the statutory conditions, the authority is bound to pass a speaking order and give reasons in support of its finding that the taxpayer is not entitled to the approval or exemption. The appellate and revisional authorities likewise must pass speaking orders. In fact Article 141 of the Constitution of India also mandates this.

(i) **Double taxation not permitted** – In **Jain Bros vs. Union of India** 77 ITR 107, 112 (SC) it has been broadly stated the principle of the Income-tax Act is to charge all income with tax, but in the hands of the same person only once. There could be double taxation if the legislature distinctly enactedit.

30.2 Chapter review

This chapter discusses the concept of interpretation of tax laws. The use of external aids like authors, land legislative debates, and other miscellaneous issues on statutes.

30.3 Worked examples

30.3.1 Open-ended questions

(1) (a) Explain briefly what you understand by "Interpretation of tax laws".

(b) Explain the rule of literal interpretation giving at least two decided cases.

(2) Explain the following with respect to interpretation of tax laws

(a) The Golden Rule

(b) Rule of Harmonious Construction

(c) The Doctrine of "Reading Down"

(3) (a) Explain the term "Ejusdem Generis" or "Noscitur a.Sociis"

(b) What are the effects of Marginal Notes in interpretation of tax laws?

(4) (a) Explain the term "Expressio Umus Est Exclusio Alterius".

(b) Explain the use of external aids to interpretation.

30.3.2 Suggested solutions to open-ended questions

1 (a) In the interpretation of taxing statutes, there are principles on which the interpretation of a particular statute is done by the courts and legal practitioners and tax experts are expected to have the knowledge of the in order to understand the statutes and their implications.

These fundamental principles guide the judges in interpreting the laws and also in arriving at their decisions. L.J Denning in Seafood Court Estates v Asher (1949) 2 All ER 155 had this to say:

"Ajudge must not alter the material of which the Act is woven but he can and should iron out the creases. When a defect appears, a judge cannot simply fold his hands and blame the draftsman. He must set to work on the constructive task of finding the intention of the Parliament and then he must supplement the written words so as to give force and life to the intention of the legislature.

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Justice Graham hills of the Australian High Court, his views as to the correct approach for a court to take in interpreting taxation legislation, made it clear that a court should adopt a purposive approach by applying the ordinary meanings of the words used to give effect to the legislative purpose behindthelegislation. This approach requires looking to the context of the legislation in its widest sense to give effect to the objects of the legislation. However, such approach not be used to advance any personal theories of justice.

(b) **Cardinal Rules for interpretation of taxing statutes Rule of literal interpretation**

(i) **CIT vs T.V. Sundaram Iyyengar** (1975) 101 ITR 764 (SC) If the language of the statute is clear and unambiguous, Courts must give words their plain ordinary meaning, even if it leads to an injustice. Courts have no authority to place a different construction on it, even if it leads to an injustice. It must apply it according to its terms.

(ii) **CIT vs Elphinstone Spg & Wvg Mills Co. Ltd.** 40 ITR 142 (SC) and **CIT vs Motors & General Stores Ltd.** 66 ITR 692, 699-700 (SC).No tax can be imposed on the subject without words in the Act clearly showing an intention to lay a burden upon him. In other words, the subject cannot be taxed unless he comes within the letter of the law. The argument that he falls within the spirit of the law cannot be available by the Department.

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(iv) **Rowlatt J. in Cape Brandy Syndicate vs IRC** (1921) 1 KB 64 approved in **CIT vs Ajax Products Ltd.** (1965)55 ITR 741(SC).

"In a taxing Act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look at the language used." (p.747).

Thus, when the language of a taxing statute is clear, if an assesse falls within the four corners of the statute, he is to be taxed; if not, no tax is to belevied.

(v) **Smt. Tarulata Shyam vs. CIT** (1971) 108 ITR 345 (SC). There is no scope for importing into the statute words which are not there. Such importation would be, notto construe, but to amend the statute. Even if there be a casus omissus, the defect can be remedied only by Legislation and not by judicial interpretation.

2(a) **Golden Rule (Doctrine of purposive construction)**

If the strict interpretation of the taxing statute is likely to lead to a manifest absurdity, then the golden rule of construction implies that the meaning of the words should be so effected that such an absurdity is avoided. The application of this rule is rather limited in the realm of construction of taxing statutes, since the literal rule would gain precedence over the golden rule and it is often remarked that equity and taxation are strangers – **Grey vs. Pearson** (1857) 6 HL 61, 106.

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"The Legislature is presumed to be aware of its limitations and is also attributed an intention not to overstep its limits."

3(a) **Rule of 'Ejusdem Generis' or Noscitur aSociis**

The Rule is that the meaning of a general word is restricted by the special words appearing along with it. To illustrate:

Gore vs. State .79 Ga. App: 669 (1949)
When a statute includes general terms, following specific terms, the general terms are confined to the same kind as the specific term.

"If a man tells his wife to go to the market to buy vegetables, fruits, groceries and anything else she needs, the 'anything else' would be taken to mean food and grocery items due to the rule of ejusdem generis and not cosmetics or other feminine accessories."

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It was held that advance can only mean such advance which carries with it an obligation of repayment. A trade advance, which is in nature of money transacted to give effect to a commercial transaction, cannot be treated as 'deemed dividend' falling within ambit of provisions of section 2(22)(e). Rule of noscitur a sociis was applied.

(b) **Marginal notes** – Marginal notes to the sections cannot control the construction of the statute – **CIT vs. Ahmedbhai Umarbhai** 18ITR 472, 487 (SC); **Chandroji Rao vs. CIT** 77 ITR 743, 745-6 (SC)], but they may throw light on the intention of the legislature – **CIT vs. Vadilal Lallubhai** 86 ITR 2,11 (SC).

4(a) **Rule of 'Expressio Unius Est Exclusio Alterius' (Expression of one thing implies Exclusion of other Similar Things).**

This rule means that where there are two mutually exclusive items, the inclusion of one would implicitly mean the exclusion of the other. The above rules are the most basic rules of interpretation and the Courts use them along with certain Acts like the General Clauses Act, 1897 and the State General Clauses Act, to ascertain meanings of words not defined in the Act.

Roman vs. Terrell, 195 Ga. App.219 (1990)
When one thing is included in a statute, similar things not mentioned in the statute are deemed to be excluded.

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If same things (of many) are expressly mentioned, the inference is stronger that those omitted are intended to be excluded than if none at all had been mentioned.

(b) **External aids to interpretation**

The Court may also use certain external aids like works of prominent authors, dictionaries, legislative debates, etc., to interpret a statute correctly. Relevance of Finance Minister's speech to interpret tax statutes: The words of the statute do themselves best declare the intention of the law given. It is only if there is any ambiguity in the language, in understanding the intention of the Legislature that the aid can be taken of the proceedings in the Parliament including the aims and objects of the Act. Section 57 of the Evidence Act not only enables but enjoins the duty upon the Courts to take judicial notice of the course of proceedings in the Parliament.

31

Taxation of digital economy

Contents

31.0

Purpose

At the end of this chapter, readers should be able to:

(a) Discuss an overview of the digital economy—web portals, digitised middlemen, and e-business models;
(b) Discuss impact of IT on transaction processing and taxable entities, including the digitised middlemen;
(c) Examine data analytics tools for data gathering and analysis for tax purposes;
(d) Discuss IT tools for effective tax audit and reporting, such as data analytic tools including excel, active data, ACL, IDEA, etc.); and
(e) Explain the application of blockchain technology in tax collection and management.

31.1 Introduction

For many years, a good number of accountants have been engaged in either tax practice or tax administration with so many challenges bordering on non- application of information technology to tax issues.
Available evidence show that many tax practitioners and administrators are facing challenges due to changing operating environment, including disruptive technologies.

Professional firms have been facing more pressure than ever to deliver value to clients due to the impact of COVID 19 pandemic. On the other hand, tax administrators at the Federal, State and Local Government levels are seen to be playing catch-up in technology adoption as many of the revenue authorities still carry out their work manually.

According to the IMF, a typical developing economy collects just 15% of GDP in taxes, compared with the 40% collected by a typical advanced economy. This raises a valid question of whether this gap is created by level of technology adoption.

Tax practitioners and administrators can make use of information technology to enhance their work and make them more relevant and efficient in today's dynamic environment.

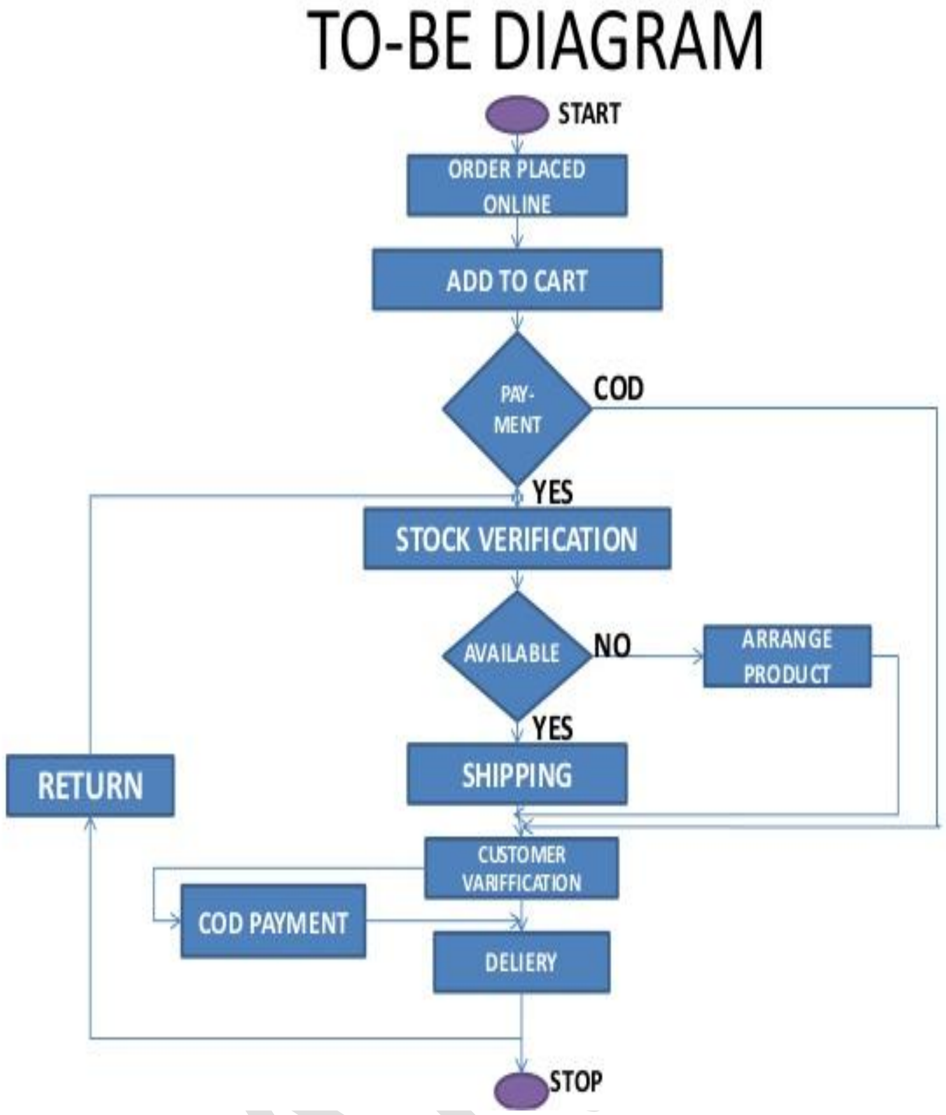
31.2 Overview of taxation in digital economy

Digital economy refers to an economy that is based on digital technologies. The digital economy is also sometimes called the internet economy, the new economy, or web economy. Increasingly, the "digital economy" is intertwined with the traditional economy making a clear delineation harder.
There is a general consensus that the current global and national legal/tax frameworks were not designed for taxation of the digital economy which presents major challenges in applying the principles under the general tax rules to taxation of digital transactions.
It is obvious that digital transactions, such as those from e-commerce generate significant revenues for companies and individuals that operate within the digital space. The huge inflows and outflows in most cases have not resulted in the expected corresponding increase in tax revenue within the jurisdictions where these transactions occur.
One primary reason for the mismatch is that a number of service providers within the digital space are not captured within the tax net because they do not have an identifiable physical presence in jurisdictions where these economic activities take place.
The challenges include:

- Most economies across the globe are undergoing digital transformation which has brought about digitilisation of transactions mainly through e-commerce. These transactions appear to be growing at exponential rate much higher than transactions from the traditional channels and this is not expected to stop; and
-
- Tax authorities, especially those in the Africa and other developing countries, are still challenged with revenue collections and audit of the digitalised economy. Some of the big digital players have failed to consider the jurisdictions where their services are consumed when paying or remitting taxes.

31.3 The mechanism of e-commerce

Business transactions that occur on the internet are referred to as e-commerce transactions which generally involve online buying and selling of goods and services.



Source: www.slideshare.net/ecommerce-business-process

There is a process that accepts the customer's order. The software that runs this process is called a shopping cart. In addition to making a note of what is being purchased and updating the order database, the shopping cart performs several other tasks:

(a) Computing taxes and other levies;

(b) Processing of coupons and other discounts;

(c) Capturing the billing and delivery address of the customer;

(d) Ensuring user acceptance of terms of service and other conditions of sale;

(e) Creating codes, such as invoice numbers, order number, tracking number, etc; and

(f) Forwarding customers to the payment gateway.

i. The payment gateway

In most cases, an e-commerce transaction involves transacting money. This process is conducted by a piece of software called the payment gateway.

The payment gateway presents customers with payment options, accepts identification details, such as credit card numbers, and authenticates customers using a password, CVV code, or multiple factors of authentication, creation of codes, such as invoice numbers, order number, tracking number, etc.

ii. Why e-commerce is the future

E-commerce business is not going away anytime soon due to the following reasons:

- Enables 24/7 buying and selling;
- No geographical boundaries;
- Low operational cost;
- Streamlined transaction processes – guarantees speed; and
- Easy to start and manage the business.

31.4 Overview of the technological impact on tax practice and administration

Tax practitioners are independent firms licensed to provide tax-related services to their clients, while tax administration refers to revenue agencies or authorities with the mandate to assess, collect and account for taxes on behalf of the government.

a. Current roles of tax practicing firms

Tax practitioners provide independent services to their clients which include:

i. Preparation of tax records;

ii. Computation of end of year tax liabilities;

iii. Filing of tax returns;

iv. Advisory to clients on tax matters;

v. Compliance with tax legislations;

vi. Resolution of tax disputes; and

vii. Management of tax audit and investigation.

Evidence from technological advancements reveal that most of these tasks can be made more efficient and effective through automation.

b. Elements of tax practice

There are four elements of tax practice as highlighted below. These elements could be enhanced by leveraging on new technologies described in the next section.

i. **Tax Compliance:** - This involves:
   - Gathering of relevant tax information;
   - Evaluating and classifying the information;
   - Filing of necessary tax returns; and
   - Representing clients during tax audits, investigation, etc.

ii. **Tax planning and advisory: -** This involves:
   - Arranging client's transactions to optimise (usually minimise) tax liability , that is, tax avoidance or evasion schemes; and
   - Planning for:
     - Open transactions

       These involve planning the timing and amount for pending future transactions to reduce any associated tax implications; and

     - Closed transactions

       These relate to how to present and classify past transactions in the accounts to reduce their tax exposure.

iii. **Tax litigation:** - This involves:
   - Settling disputes with tax authorities in a law court or tribunal. It also involves reading, understanding and citing a lot of the provisions of extant tax laws and regulations;
   - Appearing as an expert or technical witness in court of law on behalf of clients; and
   - Appealing on behalf of clients when necessary.

iv. **Tax research and intelligence:** - This involves:
   - Identifying a tax problem;
   - Gathering the relevant evidence or information for tax purposes;
   - Evaluating several scenarios relating to the challenge; and
   - Determining and outlining the solutions to the problems.

31.5 Current roles of tax administrators

Tax administrators are public authorities empowered to assess, collect and account for taxes for a recognised jurisdiction. Their roles include, but not limited to:

i. Registration and education of taxpayers;
ii. Receiving tax returns filed by taxpayers;
iii. Assessing taxpayers (individual and entities);
iv. Collecting, maintaining records and accounting for taxes paid;
v. Managing and processing tax refunds applications;
vi. Conducting routine tax audits, investigations, etc;
vii. Managing and enforcing tax debt recovery; and
viii. Advising on the review of tax legislations and regulations.

31.6 The effects of technology on modern tax administration in Nigeria

In 2006, the Federal Inland Revenue Service (FIRS) deployed the first tax portal (Webportal) which was implemented to automate and streamline taxpayers' registration and other tax administration processes. In 2014, an Integrated Tax Administration System (ITAS) known as SIGTAS was implemented though it appears its deployment was stalled.

Recently, the FIRS announced the adoption and deployment of a locally developed tax management solution known as **TAXPRO MAX**. This system has the capacity to handle different aspects of tax administration including:

- E-registration: - Deployment and use of arobust and integrated tax management software makes it possible for accurate taxpayers' data to be captured by the tax authority. Each taxpayer enrolled is assigned a unique tax identification number (TIN) and it is now possible for taxpayers to do self-enrolment through a web application service.
- E-assessment: - When taxpayers file returns electronically, it is possible for their tax liabilities to be computed and assessment notice generated automatically and sent to their email accounts.

- E- payments: - Technology has made it possible for taxpayers to make payments through several electronic channels, such as point of sale (POS); internet banking; bank transfers; unstructured supplementary service date (USSD) or even using their credit/debit cards from the comfort of their homes.

- E- filing: - Most integrated tax management solutions come along with a module that facilitates electronic filing. This enables taxpayers to file their returns from their offices without the stress of going to the tax office which might be several kilometers away. For instance, the FIRS has been encouraging taxpayers to make use of the recently deployed TaxPro solution to file their periodic tax returns, including VAT and CIT returns.

- E-tax calculator: - Modern tax authorities develop and deploy this tool on their websites to enable taxpayers and their consultants to compute the accurate amount of taxes to be paid. This function has been part of the FIRS website (www.firs.gov.ng) in the last few years.

- E-TCC: - Many individual and corporate taxpayers require their tax authorities to issue tax clearance certificates (TCCs) to them on yearly basis. Through the use of appropriate technology, taxpayers can apply for their TCCs electronically and getthem sent to their email accounts, if the conditions are met.

- E-reporting: - Each tax authority requires various performance reports to be generated on a periodic basis. These reports can be generated within seconds at the click of a button.

- E-tax audit: - Technology has made it possible for the entire process of tax audit to be carried out without the tax auditors visiting the premises of the taxpayer and vice versa. For instance, all the pre and post –audit meetings can be held using video conferencing tools and documents exchanged electronically through emails.

31.7 New technologies for tax practice and administration

Two different future trends in tax that both rest on information technology are:

a) **Increasing use of digital technology –** Tax professionals will use increasingly sophisticated technologies to enhance their traditional ways of serving clients. This is already happening today across the globe; and
b) **A radical shift (total takeover) –** Here, technology does not simply streamline and optimise that traditional approach, it actively displaces the work of traditional tax professionals.

Digital transformation inspired by unprecedented pace of technological advancement is disrupting nearly every industry, and taxation is no exception. Some of the new technologies disrupting the taxation industry include:

a) **Cloud computing technology:** Many accounting software are hosted in the cloud. Some of them come along with modules for tax management used for:

i. Automated tax computation;
ii. Tax returns preparation and filing;
iii. Tax planning and forecasting; and
iv. Tax payment; etc.

In most advanced tax environments, there are cloud-based independent automated solutions for tax management. When a tax practice or administration subscribes to a cloud-based tax management solution, it is relieved of the need to invest in physical onsite servers with the attendant costs of maintenance and support.

Cloud-based tax management solutions afford tax practitioners the opportunity to work remotely from practically any device with internet connection and serve their clients from any location at any time. It further helps tax practitioners to facilitate collaborations among themselves and clients.

(a) **Artificial intelligence and robotics:** - Traditionally, tax practitioners put a lot of efforts in collating and analysing financial data in order to serve their clients and taxpayers. Artificial Intelligence (AI) and Robotics make it easier for tax practitioners to simplify and accelerate various data-related tasks. Robotic Process Automation (RPA) software has been demonstrated to be effective in handling routine and monotonous aspects of the tax man's job.

AI is capable of making tax practitioners and administrators more productive as its algorithms allow machines to take over time-consuming, repetitive, and redundant tasks. Rather than just crunch numbers, tax professionals will be able to spend more time delivering actionable insight on tax implications of past and future transactions of the company.

Machines can help reduce costs and errors by streamlining operations. For instance, the optical character recognition (OCR) technology enables practicing firms to automate and accelerate manual entries by converting textual data to digital files using scanners and mobile device cameras.

Apart from automating the repetitive and mundane tasks of tax practitioners, AI would enable tax practitioners focus on high value functions such as tax advisory services based on deeper insights of client's data.

(b) **Blockchain technology:** Blockchain technology became popular globally through the advancements in digital currency transactions such as Bitcoin. Many businesses now leverage on the blockchain technology to record their financial and non-financial transactions in an open, secured and decentralised ledger.

Where the tax consultant or the tax authorities are made part of the transaction flow and given access to the data chain, it makes it possible for all parties to see each transaction and determine the tax implication. The blockchain can equally be used to facilitate tax payments to the government at highly reduced processing cost.

Blockchain enables smart contracts, protecting and transferring ownership of assets, verifying people's identities and credentials, etc. Once blockchain is widely adopted, and challenges around industry regulation are overcome, it will benefit businesses by reducing costs, increasing traceability and enhancing security.

(c) **Data analytics technology:** - Data has become the new cash as it is extremely crucial to make useful business financial decisions. Today, data is not just numbers and spreadsheets that accountants and tax practitioners have been familiar with for years. It also includes unstructured data that can be analysed through automated solutions.

Data analytic software can allow for real-time status monitoring of financial matters including their tax implications. Data is the fuel that powers other technology trends that are transforming finance and accounting. In the financial realm, data produces valuable insights, drives results and creates a better experience for clients. Since everything leaves a digital footprint, the unprecedented digitalisation of our world is creating opportunities to glean new insights from data that was not possible before.

These insights help tax administrators to improve internal operations and build revenue for the government. Through data analytics software, tax practicing firms could offer more valuable advisory services to their clients.

(d) **Social media technology:** - Social media platforms have been with us for a while and they have become useful tools in the hands of tax practitioners and administrators. Primarily, the social media platforms are used for dissemination of tax information due to its wide reach and appeal to the younger generation. Beside information sharing, platforms such as Facebook; Instagram; Twitter; LinkedIn; etc; are useful for collaboration among tax professionals and institutions.

A lot of tax practitioners have made themselves more visible and attractive to clients through the use of social media platforms.

(e) **Mobile app technology:** Tax practitioners can use their mobile devices to access the financial data of their clients anytime and anywhere especially where the client has adopted cloud accounting technology. Also, tax administrators and practitioners could develop and deploy mobile apps which taxpayers and clients respectively could download and install for tax updates and news.

31.8 Impact of new technologies for tax practice and administration

The use of some of these technologies in tax practice and administration brings the following benefits:

- Customer satisfaction: There would be enhanced perception of overall tax practice and administration performance;
- Lower cost of compliance: Members of staff of the tax authority would be able to focus on more valuable activities;
- Data error is minimised: Improvement in the quality of taxpayers' information; and
- Improved voluntary compliance: The compliance level of most taxpayers is bound to improve which would in turn impact positively on revenue generation.

For tax practising firms, the following benefits could be derived:

- Time savings – speed and accuracy of data entries and processing;
- Cost savings in the long run;
- Focus on higher level jobs that machines cannot handle;
- Mobility of service; and
- Increased capacity to serve multiple clients.

31.9 - Taxes applicable to technology-based transactions

E-business and e-commerce have become the order of the day across the globe as most economic transactions are today executed online real-time. Some good examples of e-commerce transaction are:

(a) Online shopping;

(b) Online movies;

(c) Internet banking;

(d) Online ticketing and reservation;

(e) Auction sites;

(f) Journal subscription; and

(g) Online betting and gaming.

One wonders if the players in the digital space such as Google; Apple; Microsoft; Facebook; Jumia; Konga; etc pay the right amount of taxes to the various jurisdictions where their services are consumed. Do they have physical presence in all the countries where their services are taken?

Generally, income generated from technology-based transactions are not exempted from income taxes. Most of the traditional tax types such as VAT, WHT, CIT and PIT are equally applicable to technology-based transactions, such as e-commerce transactions.

Some multinational companies now prepare their financial statements that clearly show transactions from digital business as a separate line.

However, due to the problem of no physical presence of most of the digital companies, many countries appear to introduce special taxes based on the concept of significant economic presence (SEP) in line with Organization for Economic Cooperation and Development (OECD) framework. As at October 14, 2020, Austria, France, Hungary, Italy, Poland, Spain, Turkey, and the United Kingdom (UK) had implemented a digital service tax (DST). Belgium, the Czech Republic, and Slovakia have published proposals to enact a DST, and Latvia, Norway, and Slovenia have shown intentions to implement same.

The UK's DST is charged at 2% on gross UK-generated revenues of large businesses providing a social media service, search engine, or online marketplace to UK-based users. The tax was applied to revenues generated from April 1, 2020. France has since imposed its own 3% tax on digital revenue for large tech companies — in effect singling out the U.S. tech giants — but has said it would withdraw the tax in favor of an international solution being negotiated under the auspices of the OECD.

In late February 2021, the US removed the stumbling block to global deal on digital tax as the Joe Biden's administration dropped the insistence on 'safe harbour' for companies adopted during the Donald Trump's administration, opening door to agreement with other countries. The OECD has predicted that an acceptable international agreement on digital service tax is likely to be reached by mid-2021.

Based on the provisions of Finance Act, 2019, which came into force on February 3, 2020, Nigeria established a new legal framework that would allow her to levy tax on the income of non-resident technology companies (NRTC) whose business activities constitute Significant Economic Presence (SEP) in Nigeria, to the extent that these companies do not already have a separate local entity incorporated. Electronic transactions were made subject to stamp duties.

The Federal Government of Nigeria (FGN) on Friday, May 29, 2020 published the Companies Income Tax (Significant Economic Presence) Order, 2020 ("the Order") in its Official Gazette No. 21, Vol 107 of February 10, 2020.

The Order provides that a non-resident company shall have a SEP in Nigeria in any accounting year, where it derives N25 million or more as annual gross turnover or its equivalent in other currencies from any or combination of some specific activities. The second sub-category includes DCs that:

- Use a Nigerian domain name;
- Register a website in Nigeria; or
- Have a purposeful and sustained interaction with persons in Nigeria by customising their digital platforms to target persons in Nigeria (localization test).

An example of the latter is where the company reflects the prices of its products in naira or provides options for billing and payment in naira.

Some countries have equally put in place policies for the regulation of cryptocurrencies and make such transactions taxable.

The recent ban placed on Twitter in Nigeria has again raised the question on whether or not these technology giants operating in the digital space are paying any tax to Nigeria.

31.10 - Technology as an effective tool for tax practitioners and administrators

According to McKinsey, by 2030, intelligent agents and robots could replace as much as 30% of the world's current human labour causing 375 million people to switch job categories.

The question therefore is -should robots be required to pay tax, considering the fact that many robots are being deployed to take over the repetitive tasks of accountants?

Technologies and their impact on tax

a) Cloud technology

Cloud technology impacts tax practice in the following ways:

- Tax management software hosted in the cloud (check out cloud service providers);
- Storage and retrieval of tax transaction data in the cloud;
- Access and analyse tax data anytime, anywhere and on any device;
- Present results in robust dashboards; and
- Collaboration and exchange of information between tax authorities and/or taxpayers.

b) Data analytics technology

Data analytics technology impacts tax in the following ways:

- The use of statistical power of modern machines to analyse volumes of data and gain better business insight;
- Identify and predict tax risk factors and anomalies; and
- Improved business and tax advisory services due to deeper insight.

This equally offers accountants and tax auditors some advantages:

- Check transactions at source;
- Review complete set of data (100 per cent check);
- Predictive analytics (assist in risk assessment); and
- Evaluation of programmed tax controls.

c) Artificial intelligence and robotics

Artificial intelligence (AI) is already in use for optical character recognition (OCR), and voice recognition and can easily be adapted in other areas of tax compliance.

AI-enabled applications (Chatbot) can deal with more complex tasks, such as answering subtle taxation queries.

This technology offers the following, among others:

- Zero data entry;
- Responding to queries;
- The machine can be made to learn from tax auditor's conclusion and uses it on future scenarios; and
- Identify patterns in both structured and unstructured transactions data – which ones are "normal and abnormal".

d) Social media technology

Social media is a medium to build relationships which can easily be used by tax practitioners to:

- Gain visibility and exposure;
- Be recognised as experts;
- Build their online network; and
- Keep the clients informed and provide better and prompt customer service.

e) Mobile app technology

Mobile apps are useful to tax practitioners in the following ways:

- Mobile accounting provides tax practitioners many benefits, such as on-demand data and information, even if they are on the go; and
- Starting a laptop or computer every time you want to work, and then go online is a waste of time when you can get all the information with just a single tap.

f) Blockchain technology

Distributed ledgers provided by blockchain technology, serves tax practitioners as follows:

- Decentralisation and distribution of shared database;
- All parties to a business transaction are involved in recording and validation from inception. This includes involving the tax authorities;
- No reconciliation needed; and
- No tax audit required.

By storing blocks of information that are identical across its network, the blockchain:

- Cannot be controlled by any single entity – decentralised to all nodes;
- Offers no single point of failure;
- Provides enhanced security through its immutable ledger;
- Provides enhanced transparency of transactions; and
- Is faster and cost effective.

31.11 Key reasons why practice firms leverage technology

Below are some benefits derivable by practice firms leveraging technology:

- **Winning more clients**: It is obvious that majority of clients would prefer to hire tax practice firms that are adaptive to technology changes;
- **Retaining more clients**: Adoption and adaptation of modern technologies would make practising firms to render the much needed valuable and improved services which make clients retain them;
- **Cross-selling services**: Technology provides platforms to enable practising firms make their services more visible to many clients; and
- **Adding greater value**: Firms that adopt new technologies are able to automate most of the routine and labour-intensive tasks. This makes it possible for such firms to focus their attention on tasks that generate greater values for their clients.

31.12 - Challenges of technology to tax practice and administration

The challenges of technology adoption in tax practice and administration include:

- Low computer literacy level;
- Poor internet facility;
- Possible cyber threat;

- High implementation cost;
- Lack of technical know-how; and
- Challenge of data validation - garbage-in; garbage-out-.

Opportunities

Opportunities for tax practitioners from technology adoption include:

- Allowing tax professionals to focus on higher level jobs while offering their services to more clients;
- Enhancing visibility to clients;
- Providing ability to offer personalised services to clients;
- Enhancing adaptability to change and offering new services;
- Saving time – become more efficient and focused on relevant data;
- Saving cost (long term);
- Enabling mobility of service – geography is now unimportant;
- Providing new skills to tax professionals;
- Enabling opportunity to work collaboratively with anyone from any part of the world; and
- Increasing tax audit quality, as it begins to allow auditors to ask a lot more questions.

31.13 - IT tools for effective tax audit and reporting

Tax auditors sometimes face challenges relating to management of audit cases mainly due to time pressure and lack of cooperation from the taxpayer selected for audit. The way to address this challenge and make the tax audit process more efficient and effective is to embrace technology.

The following technological tools could be used by the tax auditor to facilitate the audit process:

(a) **Email messaging application:** The tax auditor can use emails for most of the correspondence with the taxpayer rather than sending hard copy letters. This include sending letter for commencement of audit; letter to request for documents; audit clearance letter, etc. These letters can be scanned and attached to email messages sent to the taxpayer;

(b) **Video conferencing solutions:** Though video conferencing tools have been there for many years, it took the COVID 19 pandemic that ravaged the world in 2020 to make their usage more pervasive. A lot of meetings, events, conferences, etc are now being held virtually involving people from different distant locations. Tax auditors can leverage on any of the tools to hold pre-audit meetings; exit meetings; reconciliation meetings; etc.

   Some of the popular video conferencing tools include:
   i. Zoom;
   ii. Google meet; and
   iii. Microsoft teams.

(c) **Data analytic and audit tools:** Tax auditors can make use of data analytic tools to collate and analyse financial and non-financial data on the selected taxpayer for audit. When auditing big organisations, a tax auditor is usually faced with large amount of data which might take him several days/weeks to analyse. With the help of a data analytic tool, he can scrutinise the data in few minutes and make good meaning of it for the purpose of computing the actual tax liability of the taxpayer.

Some of the popular data analytic and audit tools available to tax auditors include:

i. MS-Excel application;
ii. Active data software;
iii. Audit Command Language (ACL) software;
iv. Integrated Data Extraction and Analysis (IDEA) Audit software; and
v. TeamMate Audit software.

(d) **Tax management software:** Most of the modern integrated tax administration systems (ITAS) come along with a module for audit management. This module when activated could be used by the tax auditors to manage the entire audit process from case selection to issuance of demand notice to the audited entity.

31.14 Chapter review

The chapter discusses:

(a) An overview of the digital economy—web portals, digitised middlemen, and e-business models;
(b) Impact of IT on transaction processing and taxable entities, including the digitised middlemen;
(c) Data analytics tools for data gathering and analysis for tax purposes;
(d) IT tools for effective tax audit and reporting, such as data analytic tools including excel, active data, ACL, IDEA, etc.); and
(e) The application of blockchain technology in tax collection and management.

31.15 Worked examples

31.15.1 Open-ended questions

1) Identify and explain four technology tools that a tax auditor could use to facilitate an audit work and reporting.

2) Comment on how the concepts of significant economic presence (SEP) and digital service tax (DST) have helped to address the tax gaps created by multinational operators in the digital space.

31.15.2 **Solutions to open-ended questions**

1. Technology tools that a tax auditor could use to facilitate an audit work and reporting include:

(a) Cloud computing technology: Many accounting software are hosted in the cloud. Some of them come along with modules for tax management used for:

(i) Automated tax computation;

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A

Appendices

APPENDICES I

Glossary of terms

Initial allowance
This is the first variant of capital allowances relief granted in the year of assessment in the basis period of which, a qualifying capital expenditure was incurred. It is granted once in the lifetime of an asset, so long as it is beneficially, owned and used by the same owner.

Instrument
This is a written document,that could be tendered in evidence, in a court of law, appeal tribunal, etc.

Investment allowance
This is an incentive granted where a company has incurred expenditure on plant and equipment or on plant and machinery. It is not taken into account in ascertaining the tax written down value of qualifying expenditure.

Itinerant worker
This is an individual who, during an assessment year, customarily works in multiple places in order to earn daily wages.

Multiple taxes
Similar types of taxes imposed on taxpayers by the different tiers of government.

Nigeria
Includes the submarine areas beneath the territorial waters of the Nigerian nation and the submarine areas beneath any other waters which are or at any time shall in respect of mines and minerals become subject to the legislative competence of the national assembly of the Nigerian nation.

Nigerian company
A Nigerian company is defined as one incorporated under the Companies and Allied Matters Act or any enactment replaced by that Act.

Pension fund
Means a society, fund, contract or scheme, the assets of which are held under irrevocable trusts and any scheme established by a law in Nigeria or elsewhere, the main objects of which are, in the opinion of the board, the provision of non-assignable and non-commutable retirement pensions or annuities for an individual or benefits for his dependants, after his death, or for any group or class of individuals and their defendants. Pension Reform Act, 2014

Progressive tax
This is a graduated form of tax, which applies higher rates of tax, as income increases. The objective of the tax is the redistribution of income from the well to do, to the less privileged.

Proportional tax
This form of tax assesses a taxpayer to tax, at a flat rate on his total assessable income. Therefore, the tax payable is proportional to the taxpayer's income.

Provident fund
Means a society, fund or scheme, (not a pension fund), established under irrevocable trusts or a law in Nigeria or elsewhere, the objects of which are the provision of retirement benefits for an individual or benefits for his dependants, after his death, or for any group or class of individual and their dependants.

Provisional tax
Provisional tax, is usually an amount equal to the tax paid in the immediately preceding assessment year, by a company, and is regarded as a payment on account of the tax, that may be payable by the company for the current year.

Qualifying expenditure
Capital expenditure incurred in a basis period that is qualified for the grant of capital allowances.

Resident in Nigeria
In relation to a company, means a company the control and management of the business of which, are exercised in Nigeria.

Residue of qualifying expenditure
Companies chargeable under PPTA
The residue of qualifying expenditure, in respect of any asset, at any date, is the total qualifying expenditure incurred less the total of annual capital allowances granted to that date, in respect of the asset. It should be noted that the amount for petroleum investment allowance, is not to be deducted from qualifying expenditure, in arriving at the residue.

Regressive tax
This is a tax that decreases as the taxpayer's income increases. This type of tax is rarely applied.

Self-assessment
Under the Companies Income Tax Act CAP C21 LFN 2004, every company/taxpayer is required to assess itself based on forecast taxable income for the year of assessment, and pay the tax thereon to the Federal Inland Revenue Service.

Settlement
A settlement, includes a person who makes or establishes a settlement either directly or indirectly. It includes a person who has provided or undertaken to provide funds directly or indirectly, for the purpose of the settlement.

Tax
In simple terms, tax is a compulsory contribution imposed by a government, on the incomes, profits, goods, services, spending or properties of corporate entities, trusts, settlements and individuals. Such taxes when collected are used for carrying out governmental functions, such as maintenance of law and order, provision of infrastructure, health, utilities and education. It is also a fiscal tool for controlling the economy.

Trust
The term trust relates to equitable obligation, binding a person, called the trustee, to deal with a property, over which he/she has custody (which is called the trust property), for the benefit of persons (beneficiaries) of which he/she may be one.

Tax avoidance
Tax avoidance arises in a situation where the taxpayer arranges his financial affairs in a form that would make him pay the least possible amount of tax without breaking any of the tax laws.

Tax evasion
Tax evasion is an act, whereby a taxpayer either refuses to pay tax, or acts in such a way as to minimise tax liability, through illegal means. Tax evasion involves outright fraud and deceit, for example, a deliberate omission of a source of the taxpayer's income from returns filed or deliberate understatement of any income.

APPENDIX II

Study and examination techniques
This appendix contains notes on: (a) Using the questions and answers provided in the manual; (b) Effective study; and (c) Examination technique.

2.1 Questions and answers

1. These questions are either

   (a) Questions intended to test the understanding of the points arising out of the particular chapter; or
   (b) Examination questions inserted at a stage where it is considered the student will be best able to give a reasonable answer.

2. Most answers are given in outline, but some examination answers go a little further, in order to provide greater guidance and provide students with the basis for study.

3. When answers are comprehensive, you could not be expected to write them in the time allowed. Do not worry, if you feel you cannot write such answers, you are not expected to. But you must grasp the main points or principles involved, which will form the basis for good marks in an examination.

4. Do not worry, if your answer differs, there is often more than one approach. You must satisfy yourself however, that it is only the approach that differs, and that you have not missed the fundamental principles.

5. Authors' comments. These have been included, to give additional points or elaborate on matters arising out of the subject covered by the question, to which it is felt, you should give some thought.

Using the answers

6. Have a shot at each question yourself, before consulting the answer, you will achieve nothing if you do not do this. Write your answer out in full or jot down the main points. Do not hurry to the answer.

7. Look at the answer. (See paragraph 5 in the case of examination answers). Study the particular area thoroughly now, making sure of your understanding. Repeat the process outlined in paragraph 7and this paragraph, after a suitable interval. You must do this, to get any benefit at all. Make sure the main points stick.

9. Just browsing through the answers will really get you nowhere. You must test yourself, by writing down your version of the answer.

2.2 Effective study

Introduction

1. These notes are intended for those who are new to studying for examination subjects, although those who are not, may also benefit. They have been written in relation to study, involving the reading of textbooks, and they apply to all subjects. It is often very difficult to pick out the important principles from such books. Careful reading of these notes, will be of benefit even in studying the manual.

General

2. Study, means more than just reading a piece of literature. It means, close concentrated reading, with a notebook at your side. Unless you are one of a few people who can absorb materials by just one general reading through it..

3. Read a small area, making notes as you go along. Then ask yourself – "what have I just learnt?" Write down what you think it was all about. Then look again and you may be surprised to find you have missed a key point or points – they must be down in your notebook and eventually in your memory.

Compilation of notebook

4. A well-compiled notebook is a must. Use block capitals or different colour inks, to headline the main areas and subdivisions of those areas. Notes made during lectures or private study should not go straight into your notebook. Take them down on a "rough" paper and write them in your notebook, as soon as possible after the lecture or study period, thinking about what you are writing.

   Memory aids

5. Mnemonics are very useful – if the sequence of points in the textbook is not significant, change it if it makes for a better mnemonic.

6. Association of the points with familiar objects, which will serve to recall them, is also useful.

7. Some people memorise things by saying them over and over out loud, others have to write them down time after time.

8. Many students have small blank cards and using one side of each card for each study area, put down the main points. They carry the cards everywhere with them and use every opportunity to study them. As they are small they are easily carried. It is surprising how much of your day can be utilised this way.

Programme

9. Map out a programme for yourself; set targets and achieve them. One thing is certain, studying is not easy, but it is not too difficult, if you go about it in an orderly purposeful way. Many students fail their examinations through bad preparation. Tackle your studies as you would a project at work, systematically. Allocate a number of hours each week to each subject. Try fixing specific times for each subject, then keep to them, by refusing to let anything keep you from your planned task.

Revision

10. Revise periodically. The nearer the examination gets, the more you should concentrate on the major headlines in your notebook and less with the supporting details.

2.3 Examination technique

First impressions

1. However well prepared you may be, you are still likely to look at the paper on the day and say to yourself, after a quick look at the questions, “There’s not much here I can do”.

2. The atmosphere of the exam room has something to do with this. Try to blot everything from your mind, other than the job in hand. Concentrate hard. If you feel a bit panicky (most people do – despite the apparent looks of serenity around you) grip the table, take a deep breath, and get on with it. Remember things are never as bad as they seem!

Time allocation

3. Allocate each question time appropriate to the number of marks after first setting aside 15 - 20 minutes (of a 3 hour paper say), for initial reading of the questions, and final review of your answers. At the end of the allotted time for a question, go on to the next – remember, the first 5 or 10 marks on the new question are more readily picked up than the last 1 or 2 on the previous question.

4. The temptation will be to say “I’ll write just one more sentence”, but before you know where you are, you would have written several more and probably just managed to scrape another mark, whereas the same time on the next question, could have earned 5 or 6 marks. Time allocation is important.

5. Always leave some writing space, between your answers to each question, as you move on, because you may recall part of the answers to earlier questions, as you answer latter questions. Then you can quietly go back to update in the space reserved.

6. If you are running out of time write down the main headings first, leaving a few lines between each – at least the examiner will see that you had the overall picture. Then go back putting in as much supporting details as you can.

General approach

7. Read the instructions at the top of the paper

8. Read the question paper once through. Make your choice of questions quickly. Pick the easiest (if one appears so) and get on with it.

Individual question

9. Read the question again carefully. The question will involve a key principle or set of principles. What are they? It is so easy to make the wrong decision at this stage, so read the question, underlining what appear to be the key words. This should help you.

10. Do not rush into action with your pen yet. Jot down on the inside back of your answer script the main headings you will use in your answer. All these will take

time – about 5 minutes or more, but the careful thought and outline answer will help you earn marks.

11. Use the particular terminology used in the question, the examiner can then link the points in your answer, to the relevant parts of the question.

12. Assumptions are sometimes required (for example because of the lack of standardisation of terminology in this subject). Having stated your assumptions, make sure that what you write is consistent with them. Do ensure, however, that your assumptions are valid and are not just a device for changing the meaning of the question to suit your knowledge!

13. Tabulate where appropriate, using block capitals, for your main headings and underline subheadings. Underline words or phrases which require emphasis. Use a ruler.

14. Leave a line between your paragraphs and subparagraphs. This makes for a good layout. However, do not skip lines within paragraphs, or on one side of the paper only – examiners are waste conscious!

15. Write out each word clearly, don't forget you are not the examiner reading your answers. In your hurry, be legible.

Charts and diagrams

16. A descriptive heading or title must be given to each diagram (using the one in the question if indicated).

17. Do not squeeze a diagram into a corner – spread it out.

18. Do not clutter your diagram up with too much detail – this defeats the objective, which should be clarity.

19. Give a key to the symbols and the different lines you have used, and again – use a ruler.

End of examination procedure

20. Have a quick look at each answer, checking for grammatical errors and badly formed letters.

21. Ensure each answer sheet has your number on it and do not leave any sheet lying on the table.

Conclusion

22. Good technique plays a large part in examination success; this is a fact. Refuse to panick, keep your head, and with reasonable preparation you should make it.

23. Remember – you do not have to score 100% to pass.

24. A final point; once you are in the examination room, stay there and make use of every minute at your disposal.

25. Practise your technique, when answering the questions set in the manual.

APPENDICES III

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