



ADVANCED TAXATION (ATAX)

STUDY TEXT

THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF NIGERIA



**ADVANCED
TAXATION (ATAX)**

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Foreword

As the global economy continues to evolve, the importance of accounting professionals with strong technical skills, professional competence and ethical awareness cannot be overstated. The swift transformation in the business world, driven by globalisation, technological advancements and sustainability considerations, have significantly impacted the finance function and the skills required by professional accountants.

To remain relevant, the Institute's syllabus and training curriculum are designed to equip students with the knowledge and competencies required to succeed in the dynamic fields of accounting and finance. These are regularly reviewed and updated to reflect current trends and future needs of users of accounting and related services.

The Institute of Chartered Accountants of Nigeria (ICAN) is committed to ensuring that its syllabus and training curriculum remain current and relevant. To achieve this, ICAN undertakes a comprehensive review of these documents every three years, supplemented by annual updates to reflect emerging trends and developments in the national and global accountancy profession.

Following a rigorous process, the Syllabus Review, Professional Examinations, and Students' Affairs Committees have developed a new 3-level, 15-subject syllabus. As approved by the Council, the new syllabus will be implemented starting with the November 2025 examination diet.

The publication of the Study Texts has consistently accompanied syllabus reviews, yielding notable improvements in the performance of professional examination candidates. To further enhance student success rates, the Council has approved the development of new learning materials (Study Texts) for all the subjects. This sixth edition, incorporates significant updates, including IT and soft skills, thereby enhancing the contents, innovation, and quality. This edition has taken into consideration all requirements of the International Panel on Accountancy Education (IPAE).

The Institute engaged renowned writers and reviewers, comprising esteemed scholars and practitioners with extensive experience in their areas of specialisation, to develop high-quality learning materials. The 15 subjects include:

Foundation Level		
1.	Business Environment	A1
2.	Financial Accounting	A2
3.	Management Accounting	A3
4.	Corporate and Business Law	A4

Skills Level		
5.	Financial Reporting	B1
6.	Audit, Assurance and Forensics	B2
7.	Taxation	B3
8.	Performance Management	B4
9.	Financial Management	B5
10.	Public Sector Accounting and Finance	B6

Professional Level		
11.	Strategic Business Reporting	C1
12.	Advanced Audit, Assurance and Forensics	C2
13.	Strategic Financial Management	C3
14.	Advanced Taxation	C4
15.	Case Study	C5

A rigorous quality control process was implemented, featuring a detailed and comprehensive review of the materials developed by the writers and reviewers by the Study Texts Review Technical Subcommittee.

These Study Texts will be valuable resources, not only for our candidates but also for students of other professional bodies, tertiary institutions, and finance and management practitioners, providing valuable resources for their studies and practices.

Chibuzor Noel Anyanechi, (Chief) BSc, MBA, FCA
Chairman, Syllabus Review Committee



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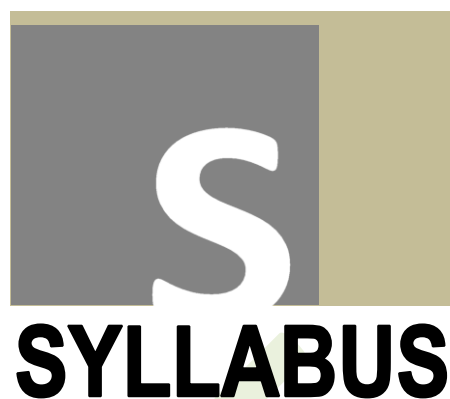
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Professional Level

Advanced Taxation



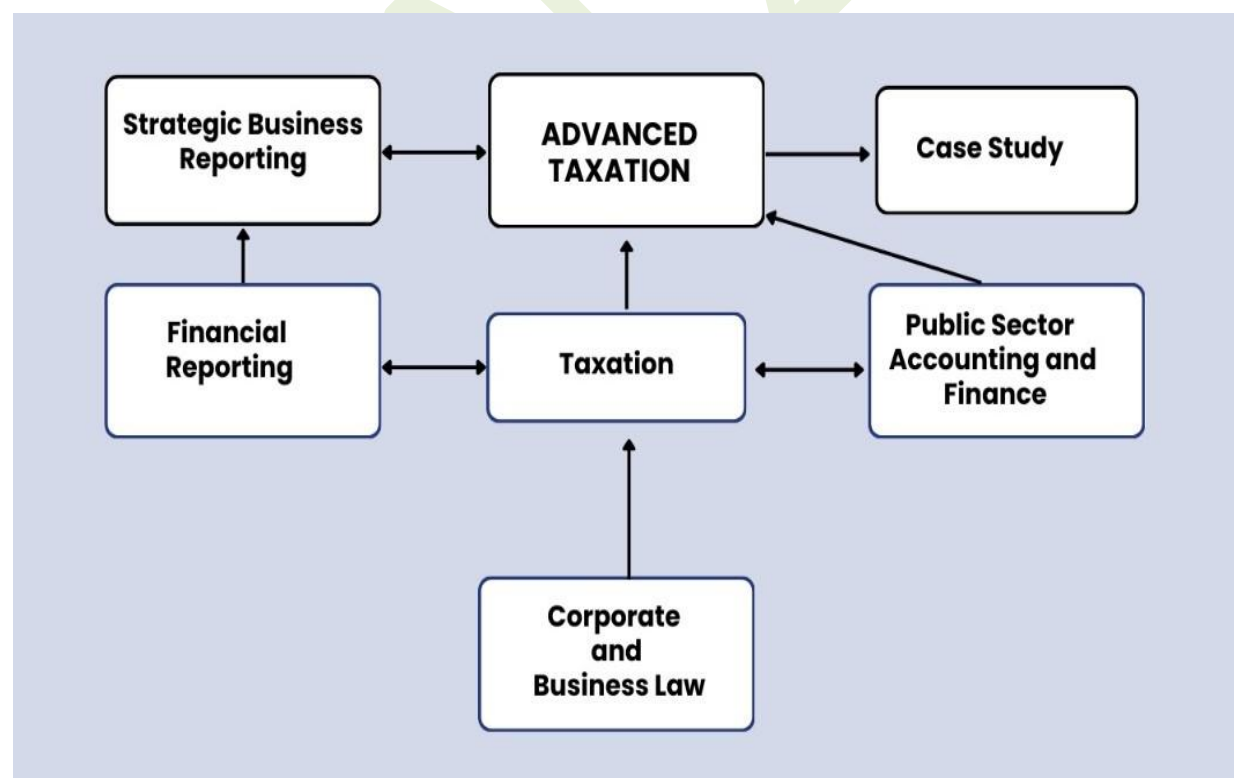
Advanced Taxation

Aim

To enable candidates, apply technical knowledge, professional skills, and exercise professional judgement to resolve tax and ethical issues that may arise in given taxation scenarios. They are also expected to advise on tax planning and mitigation strategies for businesses.

Linkage with other related subjects

This diagram depicts the relationship between this subject and other related subjects.



Main competencies

On successful completion of this paper, candidates should be able to:

- discuss tax policy formulation and apply the principles of the National Tax Policy to contextual scenarios;
- apply and advise on specific provisions of the tax laws, such as Companies Income Tax Act Cap. C21 LFN 2004 (as amended) and relevant Finance Acts, in computing the tax liabilities of companies;
- apply knowledge of tax legislations to the computation of income tax liabilities relating to corporate entities in complex situations;
- compute capital gains tax in accordance with the provisions of Capital Gains Tax Act Cap. C1 LFN 2004 (as amended) and relevant Finance Acts;
- understand taxation of the digital economy and other contemporary issues in international taxation;
- evaluate and advise petroleum companies on hydrocarbon tax and companies income tax in accordance with the relevant provisions of the Petroleum Industry Act 2021 and Companies Income Tax Act Cap. C21 LFN 2004 (as amended), and other relevant taxes;
- evaluate and advise mining companies on taxes payable in accordance with the provisions of Companies Income Tax Act Cap. C21 LFN 2004 (as amended);
- understand tax dispute resolution mechanisms;
- advise on tax planning, including alternative tax treatments to defer or minimise tax liabilities;
- gain knowledge of how to run and manage a tax practice; and
- recognise and explain ethical and legal issues arising from real life taxation scenarios.

Specification grid

The grid below shows the relative weightings of topics within this subject and should guide the study time spent on each. Over time, the marks available in the assessment will be within the ranges of weightings below, while slight variations may occur in individual assessments to enable suitably rigorous questions to be set.

	Syllabus overview	
	Grid	Weight %
A	Tax administration	5
B	Taxation of companies and investment income	35
C	International taxation	20
D	Current Issues and emerging trends	10
E	Tax management, planning, and ethics	10
F	Taxation of Incomes of extractive industries	20
	TOTAL	100

Detailed syllabus

A. TAX ADMINISTRATION

- 5%

1. Review of tax administration

(a) National tax policy

- (i) Discuss key principles and canons of tax policy formulation.
- (ii) Advise on the application of the key provisions of the National Tax Policy (NTP), 2017 in Nigeria, covering:
 - Objectives of the NTP;
 - Guiding principles of NTP;
 - Relevance of the tax system to wealth creation and employment as provided for in the NTP;
 - Responsibilities of the stakeholders under the NTP; and

- Mandates of the three-tiers of government under NTP.
- (iii) Explain the interaction of fiscal policy, monetary policy and trade policy.
- (b) Introduction to tax administration
 - (i) Explain the Nigerian tax administration system with focus on:
 - Constitutional provisions regarding fiscal federalism;
 - Structure and taxing rights of different tiers of government;
 - Roles of the three arms of government;
 - Composition and functions of the various tax organs; and
 - Challenges of multiplicity of taxes and possible solutions covering:
 - ✓ Concept of multiple taxation;
 - ✓ Causes of multiplicity of taxes;
 - ✓ Impact of multiplicity of taxes on tax compliance and revenue yield; and
 - ✓ Possible solutions to the issue of multiple taxation.
 - (c) Objections and appeals
 - (i) Discuss the elements of a valid objection and appeal procedures, covering:
 - Time limit for objections and appeals;
 - Contents of a notice of objection and appeal;
 - Amendment of assessment and refusal to amend;
 - Appeal procedures and processes (Tax Appeal Tribunal, Federal High Court, Federal Court of Appeal and the Supreme Court); and
 - Alternative dispute resolution (ADR) mechanisms.
 - (ii) Draft a report to your client on the procedure for the presentation of cases before a Tax Appeal Tribunal.

B. **TAXATION OF COMPANIES AND INVESTMENT INCOME**

- 35%

1. Companies' income tax (CIT)

- (a) Legal framework

Explain the legal framework for the imposition of taxes on companies and investment income.
- (b) Basis period

Determine, in line with the provisions of the relevant Finance Acts, the basis period and explain the rules on:

 - (a) Commencement of business;

- (ii) Change of accounting date; and
 - (iii) Cessation of business.
 - (c) Compute and advise on income tax liability of companies based on Companies Income Tax Act Cap C.21 LFN 2004 (as amended) and changes introduced by the relevant Finance Acts, covering:
 - (i) Assessable profit and total profit;
 - (ii) Minimum tax;
 - (iii) Dividend distribution; and
 - (iv) Gross Revenue/turnover.
2. Taxation of investment income
- (a) Discuss the taxation of the following investment income of Nigerian and non-Nigerian companies, in line with provisions of CITA 2004 (as amended), Withholding Tax Regulations 2024, and other relevant laws:
 - (i) Dividend;
 - (ii) Interest;
 - (iii) Royalty; and
 - (iv) Rent.
 - (b) Discuss the taxation of real estate investment companies.
3. Taxation incentives
- (a) Discuss the tax implications of the following pioneer legislations: Industrial Development (Income Tax Relief) Act, Cap. 17 LFN 2004 (as amended); pioneer status incentive regulations released by Nigerian Investment Promotion Commission (NIPC) in 2014 and 2017; and application guidelines for pioneer status incentive issued by Federal Ministry of Trade and Industries on August 2017, on the:
 - (i) Various pioneer industries and products on the pioneer list;
 - (ii) Procedure for applying and obtaining pioneer status and how pioneer certificate can be amended;
 - (iii) Provisions relating to retrospective operations and the date of production certification;
 - (iv) Conditions relating to qualifying capital expenditure for pioneer industries. Circumstances for the cancellation of pioneer certificates;
 - (v) Tax relief period and the conditions for extension of pioneer period;
 - (vi) Tax incentives available to pioneer industries;
 - (vii) Application of the commencement and cessation provisions to pre-and post-pioneer period, together with the treatment of losses and capital allowances of pioneer period;

- (viii) Various restrictions applicable to pioneer industries;
 - (ix) Tax incentives for gas utilisation as specified by the CITA, Fiscal Incentives for Downstream Gas Utilisation, 2024 and relevant Finance Acts;
 - (x) Digital economy incentives, startups (Nigerian Start-up Act 2022; and
 - (xi) Tax incentives for small businesses, manufacturing, agricultural and exports business.
- (b) Explain the tax implications of operations in the free trade zones.
4. Capital gains tax (CGT)
- (a) Discuss the concept, scope and administration of capital gains tax.
 - (b) Identify allowable and disallowable expenses.
 - (c) Explain the exemptions from capital gains tax in line with the provisions of relevant Finance Acts.
 - (d) Explain the disposal and acquisition of assets (full and partial).
 - (e) Evaluate and apply chargeable gains and capital gains tax.
 - (f) Discuss special situations under CGT, such as artificial or fictitious transactions, location of assets, determination of market value, anti-tax avoidance provision.
 - (g) Discuss planning and reliefs in respect to the provisions of the Capital Gains Tax Act 2004 (as amended) and relevant Finance Acts in relation to:
 - (i) Replacement of business assets (rollover relief); and
 - (ii) Delayed remittances
 - (iii) Capital losses carried forward
 - (h) Discuss restricted tax exemption on compensation for loss of office.
 - (i) Discuss capital gains tax in relation to business combination amongst related parties.
 - (j) Identify and explain the offences and penalties.
5. Taxation of leases
- (a) Discuss the following guidelines on the tax implications of leasing in line with the provisions of IFRS 16:and the Federal Inland Revenue Service (circular No. 2010/01) published in April 2010:
 - (i) Concept of leases;
 - (ii) Classes of leases, such as;
 - Finance lease;
 - Operating lease;
 - Sub-leases; and

- Sale and leaseback;
- (b) Discuss the tax implications of lease arrangements, on both the lessee and the lessor, covering:
 - (i) Companies income tax;
 - (ii) Value added tax; and
 - (iii) Capital gains tax.
- (c) Explain capital allowances under lease arrangements.
- (d) Explain leasing as a separate line of business.
- (e) Explain recognition, measurement, presentation and disclosure of leases by corporate entities.
- (f) Discuss the treatment of COVID-19- related rent concessions (IFRS 16, amended), 2020.
- (g) Discuss the interest rate benchmark reform- Phase 2 relating to changes in the bases for determining contractual cash flows of financial assets, financial liabilities and lease liabilities.
- (h) Explain lessor's forgiveness of lease payments.
- (i) Explain lease term and useful life of leasehold improvements.
- (j) Explain lease liability in a sale and leaseback (IFRS 16, amended), September, 2022.

C. INTERNATIONAL TAXATION

- 20%

1. Non-resident taxation

- (a) Explain the various forms of tax presence of a non-resident company doing business in Nigeria.
- (b) Evaluate the tax implications of non-resident companies doing business in Nigeria.

2. Taxation of the digital economy

- (a) Explain the concept of digital economy.
- (b) Evaluate the key challenges of taxing digital goods and services.
- (c) Discuss the existing legal/administrative framework for taxing digital transactions taking into consideration the provisions of the relevant Finance Acts.
- (d) Discuss the provisions of the relevant Finance Acts on digital services and other services in relation to significant economic presence (SEP) of a foreign entity and the SEP order signed by the Minister of Finance.
- (e) Discuss global trends in digital taxation, such as the OECD's Pillar One and Pillar Two initiatives.

3. Tax treaties

- (a) Discuss the following:
 - (i) Unilateral relief;
 - (ii) Double taxation agreements; and
 - (iii) Multilateral treaties.
- (b) Advise on the application of tax rules and reliefs available as follows:
 - (i) Administrative process of obtaining a relief issued by the FIRS;
 - (ii) Reliefs under the commonwealth tax relief;
 - (iii) Impact of double tax treaty;
 - (iv) Resolution of conflicts between double taxation agreements (DTAs) and Nigerian tax laws; and
 - (v) Nigerian double tax agreements (DTAs) in respect of the following:
 - Permanent establishment;
 - Taxation of business profits and incomes from movable and immovable properties;
 - Taxation of investment incomes; and
 - Dispute resolution mechanisms.
- (c) Discuss the role of Vienna convention in application and interpretation of tax treaties.

4. Transfer pricing

- (a) Introduction to transfer pricing
 - (i) Discuss the following:
 - Transfer price/pricing;
 - The legal framework for transfer pricing in Nigeria;
 - The significance of transfer pricing;
 - The various tax convention Models, including:
 - ✓ Organisation for Economic Cooperation and Development (OECD);
 - ✓ United Nations (UN); and
 - ✓ Pacific Association of Tax Administrators (PATA); and
 - Justifications for the application of transfer pricing regulations by multinationals and developing countries.
 - (ii) Discuss the administrative framework and procedures for conducting transfer pricing.
 - (iii) Explain benchmarking databases and technology in the transfer pricing analysis.

- (b) Nigerian transfer pricing regulations
 - (i) Evaluate and apply the provisions of the Income Tax (Transfer Pricing) Regulations, 2018, in respect of:
 - Objectives and scope of transfer pricing regulations;
 - Commencement date;
 - Connected taxable persons;
 - Transfer pricing methods such as traditional transaction methods and transactional profit methods or any other method;
 - Advance pricing agreements (APA);
 - Functional analysis in transfer pricing;
 - The basic comparability factors in the process of transfer pricing benchmarking. The basic documentation requirements for transfer pricing benchmarking;
 - Dispute resolution mechanisms; and
 - Offences and penalties as specified by the regulations.
 - (ii) Deductibility of payment for intangibles to non-resident companies.
 - (iii) Explain types of transfer pricing returns and due dates for filing the returns.
- 5. Actions against base erosion and profit shifting (BEPS)
 - (a) Explain the 13 BEPS action plans of the OECD.
 - (b) Advise on the provisions and application of the Income Tax (Country By Country Reporting) Regulations, 2018, issued by the Federal Inland Revenue Service.
- 6. Regional integration and trade blocs
 - (a) Discuss the formation and fiscal policy objectives of the Economic Community of West African States (ECOWAS).
 - (b) Explain the application of ECOWAS common external tariffs.
 - (c) Explain the objectives, operations and challenges in implementing of the African Continental Free Trade Area Agreement (AfCFTA).
 - (d) Discuss other regional trading blocs in Africa in comparison to the European Union (EU) and North American Free Trade Agreement (NAFTA).
- 7. International tax policy
 - (a) Discuss the concept and objectives of international tax policy.
 - (b) Explain jurisdiction as it relates to:
 - (i) Tax;
 - (ii) Limits;

- (iii) Collection and enforcement of cross-border tax due;
 - (iv) Source and residence; and
 - (v) Controlled foreign companies.
- (c) Evaluate the roles being played by inter-governmental and supranational organisations that shape tax policy.
- (d) Examine the roles of World Trade Organisation (WTO), General Agreement on Tariffs and Trade (GATT) and their significance to international taxation.
- (e) Evaluate international cooperation between tax administrators in different tax jurisdictions in respect of exchange of information, covering:
 - (i) Exchange of information on request;
 - (ii) Automatic exchange of information; and
 - (iii) Spontaneous exchange of information.
- (f) Identify and explain practical aspects of Nigeria's exchange of information framework, its effectiveness and challenges encountered in enforcing cross-border compliance.
- (g) Discuss the effectiveness of global cooperation and assistance on tax matters.
- (h) Evaluate the use of neutralities in international tax policy.

D. CURRENT ISSUES AND EMERGING TRENDS

- 10%

1. Current tax issues

- (a) Discuss the following:
 - (i) Tax inspectors without borders;
 - (ii) Cooperative compliance (with particular reference to FIRS policies promoting taxpayer engagement and cooperative compliance principles);
 - (iii) Simultaneous tax examination;
 - (iv) The common reporting standards;
 - (v) Foreign account tax compliance; and
 - (vi) Mutual agreement procedures (MAP).
- (b) Disruptive technologies affecting tax administration
 - (I) Explain the use of artificial intelligence (AI) in data analysis and fraud detection by tax authorities and other government agencies.
 - (II) Discuss the e-filing systems and mobile tax apps, such as the FIRS e-tax, which simplifies compliance for taxpayers.

2. Emerging trends

- (a) Taxation and sustainable development goals (SDGs)
 - (i) Discuss the following:
 - Core goals of sustainable development;
 - Role of taxation in achievement of SDGs;
 - Tax challenges in Africa and its impact on SDGs;
 - United Nations Development Programme 2021 on tax for SDGs, covering:
 - ✓ Objectives of the programme; and
 - ✓ Outcomes of programme.
 - (b) Explain the various disruptive technologies affecting tax administration.

E. TAX MANAGEMENT AND PLANNING

- 10%

1. Mergers and acquisitions

- (a) Discuss the concepts of mergers and acquisitions.
- (b) Explain the regulatory landscape of mergers and acquisitions in Nigeria.
- (c) Discuss the reporting requirements and statutory filings with the Corporate Affairs Commission (CAC) and the Securities and Exchange Commission (SEC).
- (d) Advise on the bases periods for assessment relating to mergers and acquisitions.
- (e) Discuss tax considerations for mergers and acquisitions.
- (f) Advise entities involved in business re-organisations and restructuring, taking into consideration the specified tax concessions and conditions to be met before qualifying for such concessions.
- (g) Discuss practical successful merger and acquisitions deals in Nigeria, Africa and other climes.

2. Tax practice management

- (a) Explain the legal requirements for a professional accountant in tax practice.
- (b) Describe the process involved in client and engagement acceptance.
- (c) Advise on the risks and benefits of running a professional tax practice.
- (d) Discuss the risks mitigation strategies in tax practice.
- (e) Discuss submission of objection letter via electronic and physical means.
- (f) Discuss the role of technology in running a contemporary tax practice.
- (g) Discuss the challenges encountered with using available digital technology solutions for tax compliance.

3. Tax planning, avoidance and evasion

- (a) Advise management on tax planning activities and strategies.
- (b) Differentiate between tax avoidance and evasion.
- (c) Evaluate the tax implications of the following:
 - (i) Thin capitalisation;
 - (ii) Tax havens;
 - (iii) Treaty shopping; and
 - (iv) Non-tax factors.

4. Tax audit and tax investigation

- (a) Explain the difference between tax audit and tax investigation.
- (b) Identify and discuss the different types of tax audit.
- (c) Discuss the powers of tax authority to request for an audit.
- (d) Advise management on tax audit procedures, covering:
 - (i) Pre-audit;
 - (ii) Field audit; and
 - (iii) Post-audit.
- (e) Explain tax investigation (causes and procedures).
- (f) Explain the benefits of tax health check to tax audit and investigation.
- (g) Discuss documentation in tax audit and investigation.
- (h) Discuss the power of tax authority under the law to enforce collection of unpaid tax liabilities.
- (i) Advise on ethical issues in tax administration and practice (confidentiality, conflict of interest, disclosure of information in tax practice, etc).
- (j) Advise on interpretation of tax laws using decided cases.
- (k) Discuss the role of the tax practitioner on communication with clients, tax authorities and other stakeholders.

5. Ethics and professionalism in tax management

- (a) Apply the five fundamental principles and guidance in International Ethics Standards Board for Accountants (IESBA) codes to resolve ethical dilemmas that may arise.
- (b) Discuss the various legal actions that may arise as a result of breach of the provisions of laws arising from tax assignment.
- (c) Design and evaluate appropriate ethical safeguards to mitigate threats that could arise when professionals deal with employers, clients, government agencies and other stakeholders.
- (d) Explain the practical process to follow in addressing a tax violation under the Non-compliance with Laws and Regulations (NOCLAR) framework as a:
 - (i) Professional accountant in tax practice; and

- (ii) Tax professional in business
- (e) Explain ethical issues in data privacy, client confidentiality and data handling, in line with the provisions of Nigerian Data Protection Act, 2023.
- 6. Tax accounting and reporting
 - (a) Discuss the treatment of income tax in financial statements.
 - (b) Discuss the computation and accounting for deferred taxes.
 - (c) Advise on potential risks of wrong or misleading tax disclosures in the financial statements.

F. TAXATION OF INCOMES OF EXTRACTIVE INDUSTRIES - 20%

- 1. Oil and gas taxation
 - (a) Discuss the general overview of the oil and gas industry in Nigeria in accordance with the Petroleum Industry Act (PIA), 2021.
 - (b) Discuss the objects, functions and powers of the regulators in the oil and gas industry, such as:
 - (i) Nigerian Upstream Petroleum Regulatory Commission (The Commission);
 - (ii) Nigerian Midstream and Downstream Petroleum Regulatory Authority (The Authority); and
 - (iii) Nigerian National Petroleum Company Limited.
 - (c) Explain the under listed classes of licences which are granted by the Commission:
 - (i) Petroleum exploration licence;
 - (ii) Petroleum prospecting licence; and
 - (iii) Petroleum mining licence;
 - (d) Advise on the fiscal/operating arrangement/regimes in the upstream sector, taking into consideration the relevant provisions of the Petroleum Industry Act 2021:
 - (i) Joint Venture (JV);
 - (ii) Production sharing contract (PSC);
 - (iii) Risk service contracts;
 - (iv) Oil and gas free trade zones; and
 - (v) Marginal field operators.
 - (e) Advise on what constitutes accounting period for tax purposes.
 - (f) Discuss the fiscal provisions of the Petroleum Industry Act 2021 relating to conversion, transition and compliance matters;
 - (g) Discuss the tax implications of a company with converted and non-converted licences/leases.

- (h) Ascertain the sources of income accruing to petroleum companies.
- (i) Advise on allowable and disallowable expenses and other deductions taking into consideration the provisions of the Petroleum Industry Act 2021;
- (j) Assess royalties based on production and price, using applicable rates;
- (k) Discuss the treatment of losses in the computation of hydrocarbon tax and companies income tax.
- (l) Discuss how unabsorbed losses and unrecouped capital allowances of transited companies will be treated in the computations of hydrocarbon tax and companies income tax.
- (m) Identify income chargeable to hydrocarbon tax.
- (n) Discuss the exemptions from hydrocarbon tax.
- (o) Identify and describe qualifying capital expenditure for capital allowance purposes and compute capital allowances claimable by petroleum companies.
- (p) Compute the production allowance per crude oil produced and explain its treatment in the determination of hydrocarbon tax and companies income tax.
- (q) Assess and advise on:
 - (i) Cost price ratio limit of 65% of gross revenue at the measurement points for hydrocarbon tax deduction purposes;
 - (ii) Hydrocarbon tax;
 - (iii) Companies income tax; and
 - (iv) Tertiary education tax.
- (r) Discuss tax payable based on the incentives available to companies under production sharing agreements with the Federal Government of Nigeria.
- (s) Discuss the following in line with the Oil and Gas Companies (Tax Incentives, Exemptions, Remissions, etc) Order, 2024:
 - (i) Tax credits for non-associated gas greenfield developments in onshore and shallow water locations;
 - (ii) Mid-stream capital and gas utilisation investment allowance; and
 - (iii) Incentives to deep water oil and gas projects.
- (t) Compute gas utilisation investment allowance.
- (u) Compute gas tax credits and gas tax allowance.
- (v) Discuss the funding of the Frontier Exploration Fund which shall be maintained for the exploration of unassigned frontier acreages in Nigeria.
- (w) Describe the tax regime applicable to sole risk and marginal field operators.
- (x) Explain the purposes for a decommissioning and abandonment fund to be set up by licence holders in midstream operations.
- (y) Explain the establishment, funding, and utilisation of the host community fund.
- (z) Advise on the offences and penalties applicable to petroleum companies.
- (aa) Discuss the requirements for registration and filing of returns for petroleum companies.

- (bb) Explain the dispute resolution mechanisms provided in the Petroleum Industry Act 2021.
- 2. Mining taxation
 - (a) Discuss the administrative structure of the mining industry, with reference to the split of the Ministry of Mines and Steel Development to form the Ministry of Solid Minerals Development and Ministry of Steel Development
 - (b) Advise on the scope and administration of the Nigerian Minerals and Mining Act, 2007 (as amended) and section 36 of the Companies Income Tax Act, in respect of:
 - (i) Mining incentives;
 - (ii) Minerals titles;
 - (iii) Possession and purchase of minerals;
 - (iv) Environmental considerations and rights of host communities;
 - (v) Allowable and disallowable expenses;
 - (vi) Rates of capital allowances;
 - (vii) Computation of capital allowances;
 - (viii) Total profits;
 - (ix) Treatment of losses;
 - (x) Assessment of tax liabilities; and
 - (xi) Offences and penalties.
 - (c) Discuss the Nigerian Mineral Resources Decision Support System.
 - (d) Advise on the scope and administration of the Nigeria Extractive Industries Transparency Initiative (NEITI) Act, 2007.
- 3. Environmental, social and governance (ESG) compliance in the extractive industry
 - (a) Discuss the benefits and challenges for companies adopting sustainable practices.
 - (b) Discuss ESG compliance in the extractive industry.

Guide to examination assessment

ICAN reserves the right to examine any topic in the syllabus at any examination diet.

New laws, regulations and relevant tax circulars may be examined after six months from the dates of issue.

ICAN 2025

NATIONAL TAX POLICY

Contents

- 1.0 Learning objective
- 1.1 Learning outcomes
- 1.2 Canons of taxation
- 1.3 Key provisions and the applications of the 2017 National Tax Policy in Nigeria
- 1.4 The interaction of fiscal policy, monetary policy, and trade policy
- 1.5 Chapter review
- 1.6 Worked examples

1. National Tax Policy

1.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the fundamentals of the Nigeria tax policy of 2017.

1.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

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

1.2 Canons of taxation

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

1.2.1 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 canons while imposing and collecting taxes.

1.2.2 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. Any amount of uncertainty in these respects may cause 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 administrative cost 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 from tax consultants. Ultimately, such a tax system has the potential of breeding corruption in 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 many 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 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.

1.2.3 Characteristics or canons of taxation

A good tax system must 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 to:

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

1.3 Key provisions and applications of the National Tax Policy, 2017, 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.

1.3.1 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.

1.3.2 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 consider 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;

- Ⓗ **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
- Ⓓ **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.

1.3.3 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 to 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 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.

1.3.4 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 people 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 utilisation 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 can articulate their plans for the tax system to which they will be held accountable.

1.3.5 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 harmonised.

(b) Tax compliance

Government shall apply all available resources and tools at their disposal to ensure that taxpayers voluntarily comply with their tax obligations. 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;

- (i) development of frameworks for tax amnesty to expand the tax net;
- (ii) 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 recognise and honour compliant taxpayers.

(c) Efficiency of administration

The following are important in ensuring 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.

1.3.6 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 policy and make appropriate recommendations;
- (iii) Ensure automation of collection and remittance processes of taxes by all ministries, extra-ministerial departments and agencies;
- (iv) 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;
- (v) Establish an office of tax simplification which shall be responsible for ensuring continuous improvement to tax legislation and administration;
- (vi) 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;
- (vii) 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;
- (viii) 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
- (ix) 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 organised 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.

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

1.4.1 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 underdeveloped, 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).

1.4.2 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 & 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 & 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, et al. 2009).

As noted by Anyanwu (1993), the objective of fiscal policy is to promote economic conditions conducive to business growth while ensuring that 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 enough 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 institutionalised central bank independence may not necessarily bring about an independent monetary policy (Oyejide, 2003).

1.4.3 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 to reduce inflation and increasing productivity.

Monetary policy is concerned with discretionary control of money supply by the monetary authorities (Central Bank with Central Government) to achieve stated or desired economic goals. Governments try to control the money supply because most governments believe that its

Monetary policy is the deliberate use of monetary instruments (direct and Indirect) at the disposal of monetary authorities such as central bank 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 the economy of a nation by the monetary authorities to achieve 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 realise 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. Despite realised 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 minimised but eventually eliminated.

1.4.4 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.

In 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 economic growth. The relationship between macroeconomic policies and economic growth has very much importance and has engaged economists and policy makers to analyse 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.

1.5 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.

1.6 Worked examples

1.6.1 Questions

- (1) (a) A tax system is the framework through which a government collects revenue from individuals, businesses, and other entities to fund public services and infrastructure.

Required:

Explain:

- (i) Tax policy
- (ii) Tax laws
- (iii) Tax administration

- (b) For the purpose of the National tax policy (NTP), 2017, "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

Required:

Discuss the guiding principles of National tax policy (NTP), 2017.

- (2) The National tax policy (NTP), 2017, serves as a strategic framework for guiding the development, implementation, and administration of the country's tax system. It outlines the roles and responsibilities of key stakeholders, ranging from government bodies to taxpayers and professional institutions ensuring clarity, accountability, and collaboration in achieving a fair, efficient, and growth-oriented tax environment.

By identifying and examining these stakeholders, the policy aims to foster transparency, improve compliance, and promote sustainable economic development through effective taxation.

Required:

Identify the stakeholders and their respective responsibilities under the National tax policy (NTP), 2017.

- (3) The fiscal and monetary policies are the two major instruments being used by various governments to achieve the primary objective of increasing the living standard of their citizens.

Required:

Discuss the ways by which these two instruments are being employed by the Nigerian government to improving the living standards of the citizenry.

1.6.2 Suggested solutions to questions

- 1 (a) **The tax system is a combination of the tax policy, the tax laws and the tax administration:**

- (i) **Tax policy:** The tax policies are general statements of intention, which guide the thinking and the action of all stakeholders towards the realisation of the set tax goals for example, emphasis on indirect tax which is less prone to tax evasion, and self-assessment scheme to encourage tax payer participation.
- (ii) **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.
- (iii) **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.

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

- (i) **Equity and fairness:** Nigeria tax system should be fair and equitable devoid of discrimination. Taxpayers should be required to pay according to their ability;
- (ii) **Simplicity, certainty and clarity:** Tax laws and administrative processes should be simple, clear and easy to understand;
- (iii) **Convenience:** The time and manner for the fulfilment of tax obligations shall take into account the convenience of taxpayers and avoid undue difficulties;
- (iv) **Low compliance cost:** The financial and economic costs of compliance to the taxpayer should be kept to the barest minimum;

- (v) **Low cost of administration:** Tax administration in Nigeria should be efficient and cost-effective in line with international best practices;
- (vi) **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
- (vii) **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;
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- (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 utilisation 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 can articulate their plans for the tax system to which they will be held accountable.

3. Fiscal policy and improvement in living standard

Fiscal policy 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

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 stabilising the economy spending or a reduction in taxes tends to pull the economy out of a recession; while reduced spending or increased taxes slow down a boom.

Fiscal policy is also used to reconcile the changes which government makes 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.

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 magnetise 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.

Monetary policy and improvement in living standard

Monetary policy 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.

The policy is concerned with discretionary control of money supply by the monetary authorities (Central Bank of Nigeria with Central Government) 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.

Monetary policy is the deliberate use of monetary instruments (direct and Indirect) at the disposal of monetary authorities such as central bank 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.

Monetary policy is one of the tools of controlling money supply in an economy of a nation by the monetary authorities to achieve 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.

Three basic kinds of monetary policy decisions can be made about:

- (i) the amount of money in circulation;
- (ii) the level of interest rate; and
- (iii) the functions of credit markets and the banking system.

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 rests wholly on monetary authorities which has over the years been committed to its effective control.

INTRODUCTION TO TAX ADMINISTRATION

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2 Introduction to Tax Administration

2.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the basic concepts of tax administration.

2.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

- (a) understand the fiscal federalism and the Nigerian tax administration system;
- (b) ascertain the composition and functions of the various organs of tax administration;
- (c) evaluate the limitations of tax administration;
- (d) determine the challenges of multiplicity of taxes and possible solutions; and
- (e) ascertain the impact of multiplicity of taxes on tax compliance and revenue yield.

2.2 Fiscal Federalism and the Nigerian Tax Administration System

2.2.1 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".

2.2.2 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 except for 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 LFN2004(as amended).

2.2.3 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 (now hydrocarbon 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
- (ix) 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.

2.3 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:

2.3.1 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) the 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 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.

Notwithstanding the provisions of section 4 of this Act, a member of the Board shall cease to hold office as a member of the Board if:

- he resigns his appointment as a member of the Board by notice, under his hand, addressed to the President;
- he becomes of unsound mind;
- he becomes bankrupt or makes a compromise with his creditors;
- he is convicted of a felony or any offence involving dishonesty or corruption;
- he becomes incapable of carrying on the functions of his office either arising from an infirmity of mind or body;
- the President is satisfied that it is not in the interest of the Service or in the interest of the public for the person to continue in office and the President removes him from office;
- he has been found guilty of contravening the Code of Conduct Bureau and Tribunal Act; or gross misconduct in relation to his duties; in the case of a person possessing a professional qualification, he is disqualified by a competent authority; or
- in the case of a person who becomes a member by virtue of the office he occupies, he ceases to hold such office.

(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;
- (iv) employ and determine the terms and conditions of service including disciplinary measures of the employees of the Service;
- (v) stipulate remuneration, allowances, benefits and pensions of staff and employees in consultation with the National Salaries, Income and Wages Commission; and
- (vi) 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:

- (i) assess persons including companies and enterprises chargeable with tax;
- (ii) assess, collect, account and enforce payment of taxes as may be due to the Government or any of its agencies;
- (iii) collect, recover and pay to the designated account any tax under provision of the Act or any other enactment or law;
- (iv) in collaboration with the relevant ministries and agencies, review regimes and promote the application of tax revenues to stimulate economic growth and development;
- (v) in collaboration with the relevant law enforcement agencies, carry out examination and investigation with a view to enforcing compliance with provisions of the Act;
- (vi) make, from time to time, a determination of the extent of financial such other losses by government arising from tax fraud or evasion and losses (or revenue forgone) arising from tax waivers and other related matters;
- (vii) adopt measures to identify, trace, freeze, confiscate or seize proceeds derived from tax fraud or evasion;
- (viii) adopt measures which include compliance and regulatory actions, introduction and maintenance of investigative and control techniques on detection and prevention of non-compliance;

- (ix) collaborate and facilitate rapid exchange of information with relevant national or international agencies or bodies on tax matters;
- (x) undertake exchange of personnel or other experts with complementary agencies for purposes of comparative experience and capacity building;
- (xi) establish and maintain a system for monitoring international dynamics of taxation to identify suspicious transactions and the perpetrators and other persons involved;
- (xii) 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;
- (xiii) maintain databases, 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;
- (xiv) 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;
- (xv) 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;
- (xvi) liaise with the office of the Attorney-General of the Federation, all government security and law enforcement agencies and other supervisory institutions in the enforcement and eradication of tax related offences;
- (xvii) issue taxpayer identification number to every taxable person in Nigeria in collaboration with States Boards of Internal Revenue and Local Government Councils;
- (xviii) carry out and sustain rigorous public awareness and enlightenment campaign on the benefits of tax compliance within and outside Nigeria;
- (xix) carry out oversight functions over all taxes and levies accruable to the Government of the federation and as 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
- (xx) carry out such other activities as are necessary or expedient for the full discharge of all or any of the functions under the Act

(d) Duties of the Secretary to the FIRSB

This is provided for in section 12 of FIRSB (Establishment) Act, 2007 (as amended). It stipulates that 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.

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”.

(e) Composition of the Technical Committee of FIRSB

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) the 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.

(f) Functions of the Technical Committee of FIRSB

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.

2.3.2 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:

- (i) 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;
- (ii) 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;
- (iii) 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
- (iv) the Legal Adviser of the FIRS acts as the legal adviser to the JTB and shall attend meetings and serve as adviser to the Board.

(b) Quorum

Seven (7) members or their representatives shall constitute a quorum {Section 86 (6)}.

(c) Functions of the JTB

The Board shall:

- (i) exercise the powers or duties conferred on it by the Personal Income Tax Act (PITA) and other Acts;
- (ii) advise the Federal Government, on request, in respect of double taxation arrangement with any other country;
- (iii) 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;
- (iv) promote uniformity, both in the application of PITA and in the incidence of tax on individuals throughout Nigeria; and
- (v) impose its decisions on matters of procedure and interpretation of PITA, on any State, for purposes of conforming to agreed procedures or interpretations.

2.3.3 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.
- (iv) A Director from the State Ministry of Finance.
- (v) A Legal Adviser to the State Service.
- (vi) Three other persons appointed by the State Governor on their personal merit, one each representing a Senatorial District in the State.
- (vii) 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 recommendations, where appropriate, to the JTB on tax policy, tax reforms, tax legislations, tax treaties and exemptions as may be required from time to time;
- (v) 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
- (vi) 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) Composition of the Technical Committee of SBIR

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

The Committee comprises:

- (i) Executive Chairman of the State Board as Chairman;
- (ii) The Directors within the State Service;
- (iii) The Legal Adviser to the State Service; and
- (iv) The Secretary of the State Service.

(d) Functions of the Technical Committee of SBIR

These are:

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

2.3.4 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) the State Sector Commander of the Federal Road Safety Commission (FRSC) as an observer;
- (vi) the Legal Adviser of the State Internal Revenue Service; and
- (vii) the Secretary to the Committee who shall be a member of 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 other functions as may from time to time be assigned by the Joint Tax Board.

2.3.5 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 Councillors 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.

2.4 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 ineffectiveness);
- (g) loopholes in the relevant laws; and
- (h) poor governance.

2.5 Challenges of multiplicity of taxes and possible solutions

2.5.1 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”.

2.5.2 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 for example, Value added tax (VAT) and sales/consumption tax, where the government imposes more than one tax on the same tax base for example, Companies income tax, tertiary education tax and technology levy on corporate taxpayers.

2.5.3 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) 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 ₦100 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.

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

2.6.1 Problems arising from multiplicity of taxes

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

- (a) 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 neighbouring countries on account of multiplicity of taxes and other relevant reasons; and
- (b) tax yield is very low because of numerous taxes that bring 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.

2.6.2 Possible solutions to the issue of multiple taxation

These include:

- (a) 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
- (b) Implement the recommendations of the Report of the Taiwo Oyedele-led Presidential Committee on Tax Reforms, which is currently before the National Assembly. Taxes and levies collectible by each tax organ are clearly stated with uniformity across the Federation.

2.7 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.

2.8 Worked examples

2.8.1 Questions

1. 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:

- (a) Discuss the structure of the tax administration system in Nigeria.
 - (b) Discuss the functions of **Two** (2) organs of tax administration in Nigeria.
2. Section 92 of Personal Income Tax Act, 2004 (as amended) provides the legal framework for the establishment of the Joint State Revenue Committee (JSRC) in Nigeria.

Required:

Explain the composition and functions of the JSRC.

3. While on a research visit to the country, a Nigerian American who teaches Taxation and Fiscal Policy in one of the leading universities in the United States, informed you of the outcome of his interaction with some key players in the Nigerian business environment. He submitted that these key players, especially those in the manufacturing sector, are seriously embittered about the issue of multiple taxation.

You were appointed as a consultant to handle the company's tax matters.

Required:

Discuss the causes and possible solutions of multiple taxation in Nigeria.

2.8.2 Suggested Solutions to questions

1(a) 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, Hydrocarbon 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 except for the Nigerian Armed Forces and employees of the Nigeria foreign missions through each State 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.

(b) Functions of organs of tax administration in Nigeria

(i) 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.

(ii) 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.

(iii) 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 taxpayer education; and
- responsible for collection of data and information to develop and reform tax policies legislation and administration.

2. Composition and functions of the 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) the State Sector Commander of the Federal Road Safety Commission (FRSC) as an observer;
- (vi) the Legal Adviser of the State Internal Revenue Service; and
- (vii) the Secretary to the Committee who shall be a member of 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 other functions as may from time to time be assigned by the Joint Tax Board.

3. Report explaining the causes and possible solutions of multiple taxation in Nigeria

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 States notably, Lagos State, introduced the sales tax based on the same principle as the former and made it applicable in Lagos State.

The possible causes of multiple taxation in Nigeria are:

- (i) the number of taxes which local government has constitutional rights to collect;
- (ii) Insufficient funding, especially at the state level, often leads to instances of multiple taxation, where State Boards impose additional taxes to generate revenue, even when such taxes have already been levied by either the Federal or Local governments;
- (iii) 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;
- (iv) inability of all the tiers of government to adequately fund their departments and agencies;
- (v) multiplicity of revenue agencies;
- (vi) overlapping taxing rights as contained in the Constitution and the taxed and levies (approved list for collection); and
- (vii) manual tax administration system and unorthodox tax collection mechanism.

Possible solutions to multiple taxation in Nigeria 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;
- (ii) reviewing all the existing taxes in Nigeria and harmonise where necessary, as recommended by various study groups;
- (iii) reviewing of the Constitution to address the overlap in taxing rights and limit the number of taxes that can be imposed by different levels;
- (iv) abolishing unorthodox method of tax collection and implementing technology for tax administration; and
- (v) limiting the number of revenue agencies.

OBJECTION AND APPEAL PROCEDURES

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3 Objection and Tax Appeal Procedures

3.0 Learning objective

The objective of this chapter is to enhance readers' understanding of objection and appeal procedures in Nigerian tax administration.

3.1 Learning outcomes

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.

3.2 Elements of a valid objection and appeal procedures

For a notice of objection to be valid, the following are applicable:

- a) **Timely submission:** The objection must be submitted within the stipulated time frame (30 days) to be considered valid.
- b) **It must contain clear grounds for objection:** The objection must specify in detail the grounds upon which it is made, including facts and reasons for objecting to each issue.
- c) **Completed objection form:** The taxpayer must complete the prescribed objection form, which varies depending on the type of tax under consideration.
- d) **Supporting documents:** The taxpayer must provide evidence and supporting documents to substantiate their objection.
- e) **Payment of non-disputed tax:** The taxpayer must pay all tax not in dispute as well as 50% of the amount of tax in dispute (for Value Added Tax objections).

3.3 Time limit for objections and appeals

In Nigeria's system, the time limits for objections and appeals are as follows:

- a) **Notice of objection:** a taxpayer has 30 days from the date of receiving the tax assessment to file a notice of objection.
- b) **Appeal to the tax appeal authority (TAT):** If the taxpayer is dissatisfied with the response to their objection, they can appeal to the TAT within 30 days of receiving the notice of refusal to amend (NORA).
- c) **Appeal to Federal High Court:** If a party is aggrieved by the final decision of the TAT, they can appeal to the federal high court within 30 days of receiving the TAT's decision.
- d) It is essential to note that these limits are crucial and failure to adhere to them result in the assessment becoming final and conclusive.

3.4 Contents of a notice of objection and appeal

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

- a) the tax file number;
- b) the relevant year of assessment;
- c) the date the notice of refusal to amend was received;
- d) the assessable profit for the year of assessment being disputed;
- e) the taxable/total profit being disputed
- f) the amount of tax payable disputed; and
- g) the grounds of appeal. Note that the grounds of appeal may not be different from the grounds of objection.

3.5 Amendment of assessment and refusal to amend

- a) Upon the receipt of the valid notice of objection, the relevant tax authority will examine the grounds of objection to determine its 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 within the statutory time limit of sixty days from the date of receipt of the revised assessment by the taxpayer
- b) 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.
- c) The taxpayer, if aggrieved by the notice of refusal to amend, may file a notice of appeal to the Tax Appeal Tribunal within 30 days of the receipt of the notice of refusal to amend.

3.6 Appeal procedures and processes

3.6.1 Tax Appeal Tribunal

The Tax Appeal Tribunal was established by section 59(1) of the Federal Inland Revenue Service (Establishment) Act 2007, as provided 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 legislations. These include, the Companies Income Tax Act, Personal Income Tax Act, Petroleum industries Act {PIA}, 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, Finance Acts 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 six (6) geo- political zones, with eight locations. These zones are:

North- Central Zone, North-East Zone, North-West Zone, South-East Zone, South-South Zone, and South-West Zone. Additionally, TAT has physical offices in the following locations: Abuja, Bauchi, Benin, Enugu, Ibadan, Kaduna, Gombe and Jos. These offices allow taxpayers to file appeals and have their tax disputes resolved more conveniently.

Each tax appeal tribunal is composed of a five-man panel, headed by a legal practitioner with at least 15 years' experience in tax legislation and tax matters (hereinafter referred to as "Tax Appeal Commissioners") to be appointed by the Minister of Finance.

3.6.2 Appointment and meetings of the Tribunal

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.

The Chairman shall preside at every sitting of the Tribunal and in his absence; the members shall appoint one of them as the Chairman.

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 Acts, 2020 accordingly.

- (a) 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.
- (b) The hearing of an appeal shall be commenced by the appellant presenting documents and statements which he intends to rely upon as well as the witnesses he desires to call.
- (c) The respondent or his representative may in like manner present any document or statement he intends to rely upon as well as the witnesses he desires to call.
- (d) 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.
- (e) 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.
- (f) Thereafter the other party may cross-examine the witness who may then be re-examined.
- (g) 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.
- (h) 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.

- (i) 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.

3.6.3 Tax Appeal Commissioner

a) Qualification for appointment

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.

b) 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.

c) 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.

- d) 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.

(e) 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.

f) 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.

g) 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.

h) Appointment of Secretary to the Tribunal

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;
- iii. be responsible for the direction and control of all other employees of the Tribunal; and
- iv. the official address of the Secretary appointed for each zone shall be published in the federal gazette.

i) Appointment of other staff of the Tribunal

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.

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.

j) Jurisdiction of the Tribunal

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 Industry Act, 2021 (as amended);
- iv. Value Added Tax Act CAP V1 LFN 2004 (as amended);
- v. Capital Gains Tax Act CAP S8 LFN 2004 (as amended);
- 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; and
- vii. 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.

k) Criminal prosecution

Where during 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.

l) Appeals to the Tribunal

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

- i. the official number of the assessment, the date and the year for which it was made;
- ii. the amount of total profits on which the tax was charged;
- iii. the amount of the tax charged;
- iv. the date of service of notice of refusal by the Revenue Service to amend the assessment;
- v. 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;
- vi. address for service of any notice, correspondence or other documents to be given to the appellant by the Secretary to the Appeal Commissioners;
- vii. 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;
- viii. a company may discontinue any appeal by it, on giving notice, in writing, to the Secretary;
- ix. 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; and
- x. 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.

m) 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.

n) Appeals from decisions of the Service (FIRS)

- i. 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.

- ii. 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.
- iii. 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.

o) 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.

p) Procedure before Tax Appeal Tribunal

- i. As often as may be necessary, Tax Appeal Commissioners shall meet to hear appeals in the jurisdiction or zone assigned to that Tribunal.
- ii. 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.
- iii. 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.
- iv. All notices, documents, other than decisions of the Tribunal, may be signified under the hand of the secretary.
- v. All appeals before the Tax Appeal Commissioners shall be held in public.
- vi. The onus of proving that the assessment complained of is excessive shall be on the appellant.
- vii. 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:
 - 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 above;
 - the appeal is frivolous or vexatious or is an abuse of the appeal process; or
 - 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:

- 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;
- 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;
- where upon the hearing of an appeal:
 - no accounts, books or records relating to profits were produced by or on behalf of the appellant;
 - 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;
 - 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
 - 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.

q) Procedure following decision of the Tribunal

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.

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 judgement.

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.

3.6.4 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 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 in (a) to the Secretary within 30 days after the date on which such decision was given.
- (d) 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.
- (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 the Act.

3.6.5 Right to legal representation

A complainant or appellant 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;

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.

3.6.6 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 *ex parte*;
 - (vii) set aside any order or dismissal of any application for default or any order passed by it *ex parte*; 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.

3.6.7 Further appeals to the Court of Appeal and Supreme Court

- (a) An appeal against the decision of the Federal High Court at the instance of either party shall lie to the Court of Appeal.
- (b) The Supreme Court An aggrieved party can further challenge the matter at the Supreme Court.

3.6.8 Alternative dispute resolution (ADR)

In Nigeria's tax system, Alternative dispute resolution (ADR) mechanisms are available to resolve tax disputes efficiently and effectively. The ADR mechanisms include:

- a) **Tax Appeal Tribunal (TAT):** An independent tribunal that hears appeals against tax assessments.
- b) **Mediation:** A process where a neutral third-party facilitates negotiations between the taxpayer and the tax authority to resolve the dispute.
- c) **Arbitration:** A process where a neutral third-party makes a binding decision on the dispute.
- d) **Negotiation:** Direct negotiations between the taxpayer and the tax authority to resolve the dispute.
- e) **Fast track settlement:** A mechanism that allows taxpayers to settle tax disputes quickly, usually within 30 days.
- f) Objectives of ADR mechanisms are to:
 - i. reduce the burden on the courts;
 - ii. provide a faster and more cost-effective way to resolve tax disputes;
 - iii. improve taxpayer satisfaction and compliance; and
 - iv. enhance the overall efficiency of the tax system.

The Federal Inland Revenue Service (FIRS) and the Tax Appeal Tribunal (TAT) are key institutions that facilitate ADR in Nigeria's tax system.

3.7 Procedure for presentation before the Tax Appeal Tribunal

a) Pre-hearing procedure

- i. **Filing of appeal:** The company will file a notice of appeal with the TAT, stating the grounds of appeal and the relief sought.
- ii. **Payment of filing fee:** The company will pay the prescribed filing fee.
- iii. **Service of notice of appeal:** The company will serve the notice of appeal on

- the respondent (FIRS).
- iv. **Response to notice of appeal:** The respondent files a response to the notice of appeal, stating their defence.
- b) **Hearing procedure**
- i. **Fixing of hearing date:** The TAT fixes a date for the hearing and notifies the parties.
 - ii. **Appearance:** The parties appear before the TAT, either in person or through their representatives.
 - iii. **Opening statements:** The appellant and respondent make opening statements, outlining their cases.
 - iv. **Presentation of evidence:** The parties present their evidence, including witnesses and documents.
 - v. **Cross-examination:** The parties cross-examine each other's witnesses.
 - vi. **Closing statements:** The parties make closing statements, summarizing their cases.
- c) **Post-hearing procedure**
- i. **Judgment:** The TAT delivers its judgment, either immediately or at a later date.
 - ii. **Service of judgment:** The TAT serves the judgment on the parties.
 - iii. **Appeal:** Either party may appeal the judgment to the Federal High Court.
- d) **General requirements**
- i. **Representation:** Parties may be represented by legal practitioners, accountants, or other authorized representatives.
 - ii. **Evidence:** Parties must provide evidence to support their claims.
 - iii. **Conduct:** Parties must conduct themselves in a respectful and professional manner during the hearing.

Please note that these procedures are subject to the Tax Appeal Tribunal (Procedure) Rules 2010 and the Fifth Schedule to the Federal Inland Revenue Service (Establishment) Act 2007.

3.8 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.

3.9 Worked examples

3.9.1 Questions

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

You submitted the company's tax returns to the Federal Inland Revenue Service, Lagos on June 24, 2023.

On July 28, 2023, the company forwarded to your office a BOJ assessment notice served on it on July 27, 2023 and dated July 20, 2023, with number LC/0005/23.

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 2018 accounting year, for the sum of ₦250,000,000 which developed some fault and a sum of ₦10,000,000 was spent on repairing it during 2020 accounting year.

You did object to the BOJ and it was discharged. However, during 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, 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. 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.

Required:

Identify the contents of a notice of appeal to be filed by a taxpayer with Tax Appeal Tribunal.

3. The management of ABC Limited was slammed with a liability of ₦900 million by the FIRS. VAT amounted to ₦500 million, while, the balance represented withholding tax, company income tax and education tax.

The Tax Manager requested for a breakdown of the amount stated but no response from the audit leader. The FIRS now sent in a letter inviting them for a conclusive meeting.

The management is panicking because of the fear of uncertainties. There is the myth that it is herculean to object and bring matters to the Tax Appeal Tribunal (TAT). ABC Limited contacted Odiokanka & Co., a firm of Chartered Accountants, your employer for necessary advice.

The Head of Finance, your direct supervisor, has instructed you to do a detailed procedure for presentation before the Tax Appeal Tribunal before the close of work.

Required:

Discuss the procedures relating to pre – hearing, hearing, and post- hearing for appeals to the Tax Appeal Tribunal.

3.9.2 Suggested solutions to questions

1(a)

XYZ & Co. (Chartered Accountants)
3, Badiya Street, Maiduguri,
Borno

August 10, 2023

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

Dear Sir,

RE: JAA LIMITED

Notice of objection to BOJ assessment

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

Assessment notice no.	: LC/0005/23
Date of assessment	: July 20, 2023
Date of delivery	: July 27, 2023
Period of assessment	: 1/1/2022 - 31/12/2022
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 2023 based on the accounts for the year ended December 31, 2022, were filed on June 24, 2023, which was within the due date; and
- (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.

R. O. Zaccaeus
Managing Partner

(b) Steps to resolve the additional tax liability

- (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 (section 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.

2. 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. The procedures for presentation before the Tax Appeal Tribunal are highlighted below:

a) **Pre - hearing procedure**

- (i) **Filing of appeal:** Your company will file a notice of appeal with the TAT, stating the grounds of appeal and the relief sought.
- (ii) **Payment of filing fee:** Your company will pay the prescribed filing fee.
- (iii) **Service of notice of appeal:** Your company will serve the Notice of Appeal on the respondent (FIRS).
- (iv) **Response to notice of appeal:** The respondent files a response to the notice of appeal, stating their defence.

b) **Hearing procedure**

- (i) **Fixing of hearing date:** The TAT fixes a date for the hearing and notifies the parties.
- (ii) **Appearance:** The parties appear before the TAT, either in person or through their representatives.
- (iii) **Opening statements:** The appellant and respondent make opening statements, outlining their cases.
- (iv) **Presentation of evidence:** The parties present their evidence, including witnesses and documents.
- (v) **Cross-examination:** The parties cross-examine each other's witnesses.
- (vi) **Closing statements:** The parties make closing statements, summarising their cases.

c) **Post-hearing procedure**

- (i) **Judgment:** The TAT delivers its judgment, either immediately or at a later date.
- (ii) **Service of judgment:** The TAT serves the judgment on the parties.
- (iii) **Appeal:** Either party may appeal the judgment to the Federal High Court.

d) **General requirements**

- (i) **Representation:** Parties may be represented by legal practitioners, accountants, or other authorized representatives.
- (ii) **Evidence:** Parties must provide evidence to support their claims.
- (iii) **Conduct:** Parties must conduct themselves in a respectful and professional manner during the hearing.

COMPANIES INCOME TAX

Contents

- 4.0 Learning objective
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4 Companies Income Tax

4.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the companies income tax provisions and assessments in Nigeria.

4.1 Learning outcomes

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

- (a) understand the legal framework for the imposition of taxes;
- (b) know the background to Companies Income Tax Act (CITA);
- (c) know the bases of assessing companies to tax;
- (d) understand the company incomes chargeable to tax in Nigeria;
- (e) know the profits of a Nigerian company;
- (f) understand other profits or gains exempted from companies income tax; and
- (g) Know the provisions of Finance Act, 2019 on classification of companies and rate of tax.

4.2 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) the Taxes and Levies (Approved List for Collection) Act CapT2 LFN 2004 (as amended). These relate to:
 - (i) Companies income tax (CIT);
 - (ii) Personal income tax (PIT);
 - (iii) Withholding tax (WHT) on companies, residents of FCT, Abuja and non-residents;
 - (iv) Petroleum profits tax (PPT);
 - (v) Hydrocarbon tax;
 - (vi) Value added tax (VAT);
 - (vii) Tertiary education tax (TET);
 - (viii) Capital gains tax (CGT) - companies and non-residents;
 - (ix) Stamp duties on companies and non-residents; and
 - (x) Personal income tax (PIT) in respect of members of Armed forces, Police forces and staff of Foreign Affairs Ministry and non-resident individuals.

The legislations that guide the imposition of taxes in Nigeria include:

- Petroleum Industry Act, 2021 (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 Trust Fund (Establishment, Etc.) Act, 2011 (as amended);
- Personal Income Tax Act Cap P8 LFN, 2004 and Amendment Act, 2011;
- Value Added Tax Act Cap V1, LFN 2004 and VAT Amendment Act, 2007;
- Stamp Duties Act Cap S.8 LFN 2004; (as amended);
- Federal Inland Revenue Service (Establishment) Act, 2007 (as amended);
- Other subsidiary legislations. (for example, IDA CAP 17 LFN 2004); and
- Income Tax (Transfer Pricing) Regulations 2018.

4.3 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 (now repealed and replaced with the Companies and Allied Matters Act, (CAMA) 2020). 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.

4.3.1 Identification of a company

In accordance with the Section 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.

4.3.2 Trade or business

Companies are normally formed to carry out 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 constitute trade or business and the income therefrom 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.

4.4 Bases of assessing companies to tax

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

4.4.1 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 coincides 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 and amended by section 12 of Finance Act 2019].

4.4.2 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) by section 12 of Finance Act, 2019, 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.

The preceding year basis rule shall apply to every basis period.

Illustration 1

Obiageli 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 to illustration 1

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

Illustration 2

Sokoto 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 to illustration 2

Sokoto Limited basis periods for the first four years of assessment

YOA	Basis period

	1/4/2020 – 30/11/2020

	1/12/2020 – 30/11/2021

	1/12/2021 – 30/11/2022

	1/12/2022 – 30/11/2023

4.4.3 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 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 3

Okorie 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 to illustration 3

Okorie Limited

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

YOA	Basis period	Assessable profit
		₦
2019	1/10/19 – 31/12/19	600,000
2020	-	0
2021	1/1/20 – 31/12/20	<u>2,400,000</u>
		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:

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

4.4.4 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

Apex Nigeria Limited that was incorporated in 1990, ceased operation on March 31, 2024, having been in business for about 34 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

YOA	Basis period	Due date of payment of tax
2024	1/1/23 – 31/12/23	June 30, 2024 (PYB)
2024	1/1/24 – 31/3/24	September 30, 2024 (Six months after the date of cessation)

Illustration 5

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

Solution 5

YOA	Basis period	Due date of payment of tax
2024	1/1/23 – 31/12/23	June 30, 2024 (PYB)
2025	1/1/24 – 31/8/24	February 28, 2025 (Six months after the date of cessation)

4.4.5 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 question 6

Enugu 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 6

Enugu Limited

Computation of assessable profits for relevant tax years

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 recovered	20,000
Deduct rent paid	-40,000
Adjusted profit	340,000

4.4.6 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:

- (i) 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;
- (ii) no disposal of assets post restructuring until after one year;
- (iii) no Value Added Tax (VAT) and Capital Gains Tax (CGT) on disposal of assets amongst related parties in a business restructuring; and
- (iv) exemption will be withdrawn if disposals are made within one year of restructuring.

4.4.7 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 be 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 7

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

Details		Adjusted profit (₦)
Year ended	30/06/19	400,000
Year ended	30/06/20	520,000
Year ended	30/06/21	600,000
Period to	30/09/22	470,000
Year ended	30/09/23	820,000
Year ended	30/09/24	960,000

Required:

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

Solution to illustration 7

Bako Limited

Computation of assessable profit

For 2022, 2023 and 2024 years of assessment

Year of assessment	Old date	Assessable profit (N)	New date	Assessable profit (N)
	Basis period		Basis period	
2022	1/7/11-30/6/21	600,000	1/10/13-30/9/21	544,000
2023	1/7/12-30/6/22	376,000	1/10/12-30/9/22	376,000
2024	1/7/13-30/6/23	709,000	1/10/13-30/9/23	820,000
		1,685,000		1,740,000

Workings

Profit allocation to basis period Old accounting date

2022	1/7/20 - 30/6/20	Adjusted profit given	~~N~~ 600,000
2023	1/7/21 - 30/6/22		
	12mths x N470,000	=	~~N~~ 376,000
	15mths		
2024	(1/7/22-30/6/23)		~~N~~
i)	[1/7/22-30/9/22] 3mths/15mths x N470,000		94,000
ii)	[1/10/22-30/6/23] 9mths/12mths x N820,000		<u>615,000</u>
			<u>709,000</u>

New Accounting Date:

2022	(1/10/20 - 30/9/21)	~~N~~
i)	(1/10/20 -30/6/21) [9/12 x 600,000]	450,000
ii)	(1/7/21 - 30/9/21) [3/15 x 470,000]	<u>94,000</u>
		<u><u>N544,000</u></u>

2023	(1/10/21 -30/9/22)	~~₦~~
	12mths/15mths x 470,000	~~₦~~ 376,000
2024	(1/10/22 - 30/9/23)	
	Adjusted profit given	= ₦820,000

4.5 Company income chargeable to tax in Nigeria

Section 8 of the Companies Income Tax Act (CITA) 2024 imposes tax at a rate of 30%, now amended by the Finance Act 2019 at 0% or 20% or 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 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).

4.6 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 N25,000,000 but less than N100,000,000	20%
Large companies	Annual turnover of N100,000,000 and above	30%

The Implications of classification of Nigerian companies include but not limited to:

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

4.7 Chapter review

This chapter provides a detailed explanation of the methods of assessing companies that commence, cease and change their accounting dates in line with the provisions of CITA 2004 and amended by relevant Finance Acts of 2019 and 2020.

4.8 Worked examples

4.8.1 Questions

1. Olubiyi Limited commenced business on September 1, 2019, and it prepared its first set of financial statements, covering 16 months ended December 31, 2020.

Required:

Identify the company's year - end for the first three years of assessment as well as the relevant basis periods.

2. Opari Limited makes up its account to December 31 and permanently ceased operation on April 30, 2020.

Required:

Determine the relevant year(s) of assessment and the due date for payment of tax due.

3. Abiodun & Brothers Limited had for many years prepared accounts to December 31 but in 2022 decided to prepare a sixteen-month account to April 30. The adjusted profits were as follows:

	₦
12 months to December 31, 2019	1,800,000
12 months to December 31, 2020	2,400,000
16 months to April 30, 2022	3,360,000
12 months to April 30, 2023	1,440,000
12 months to April 30, 2024	4,200,000

Required:

Compute the assessment arising from the above results.

4.8.2 Suggested solutions to questions

1. The first assessment year is 2019, which falls under the old provision. Thus, the basis period for the determination of assessable profit is September 1, 2019 – December 31, 2019. The first accounting year end is December 2019 and not December 2020.

The second assessment year is 2021 and it falls under the new provision. Thus, the basis period is January 1, 2020 – December 31, 2020. The accounting year-end is December 2020.

The third assessment year is **2022** and the basis period is January 1, 2021 – December 31, 2021.

From the analysis above, there was a gap between 2019 (1st assessment year) and 2021 (2nd assessment year). The gap was not a gap of “basis period” **but a gap of year of assessment**. This means that the company has no Companies Income Tax returns for 2020 year of assessment.

2.

Assessment year	Basis period	Due date of payment
2020	1/1/2019 – 31/12/2019	June 30, 2020 (PYB)
2021	1/1/2020 – 30/4/2020	October 31, 2020 (cessation)

3.

Abiodun & Brothers Limited Computation of assessable profits For the relevant assessment years

Old accounting date

2021 assessment year

Basis period 1/1/20 – 31/12/20

Assessable profit (Given) ₦2,400,000

2022 assessment year

Basis period 1/1/20 – 31/12/21

Profit for 16 months ended 30/4/22 = ~~₦3,360,000~~

Assessable profit for 12 months ended 31/12/20

= $12/16 \times \text{₦}3,360,000$ ₦2,520,000

2023 assessment year

Basis period 1/1/21 – 31/12/22

Profit for 4 months (Jan – April 2022)

= $4/16 \times \text{₦}3,360,000$ ₦840,000

Profit for 8 months (May – Dec 2022)

= $8/12 \times \text{₦}1,440,000$ 960,000

Assessable profit 1,800,000

New accounting date

2021 assessment year

Basis period 1/5/19 – 30/4/20

Profit for 8 months (May – Dec 2019)

= $8/12 \times \text{₦}1,800,000$ ₦1,200,000

Profit for 4 months (Jan – April 2020)

= $4/12 \times \text{₦}2,400,000$ 800,000

Assessable profit 2,000,000

2022 assessment year

Basis period 1/5/12 – 30/4/21

Profit for 8 months (May – Dec 2020)

= $8/12 \times \text{₦}2,400,000$ ₦1,600,000

Profit for 4 months (Jan – April 2021)

= $4/16 \times \text{₦}3,360,000$ 840,000

Assessable profit 2,440,000

2023 assessment year

Basis period 1/5/21 – 30/4/22

Assessable profit for 12 months ended 30/4/22

= 12/16 x ~~₦~~3,360,000

₦2,520,000

Summary of assessable profits

Assessment year	Old accounting date ₦	New accounting date ₦
2021	2,400,000	2,000,000
2022	2,520,000	2,440,000
2023	<u>1,800,000</u>	<u>2,520,000</u>
Total	<u>6,720,000</u>	<u>6,960,000</u>

Recommendation: The practice of the tax authority is to select one of the two assessments that gives the higher tax income. In this situation, the company will be assessed to tax based on the new accounting date. This is because the total assessable profits of ~~₦~~6,960,000 is greater than that of the old accounting date of ~~₦~~6,720,000. Thereafter, the company will be allowed to change to its new accounting date of April every year.

ASCERTAINMENT OF ADJUSTED PROFIT

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5 Ascertainment of Adjusted Profit

5.0 Learning objective

The objective of this chapter is to enhance readers' understanding of ascertainment of adjusted profits of corporate businesses.

5.1 Learning outcomes

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

- (a) understand the reasons why business profits may not be acceptable directly for the computation of companies income tax;
- (b) know those expenditure items allowable as deductions from business income for tax purposes;
- (c) understand those expenditure items not acceptable as deductions from business income for tax purposes;
- (d) know the types of donations allowable as deductions from business income in the ascertainment of adjusted profit; and
- (e) know amendments made to allowable and disallowable expenses by Finance Acts, 2019 and 2020; and
- (f) know the procedure for the computation of adjusted/assessable profit.

5.2 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.

5.3 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 allow 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:
 - i. 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
 - ii. 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 in which the profits are being ascertained; and
 - iii. 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 conditions 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 regarding 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	<u>15,000</u>	Charged to P or L A/C	<u>14,000</u>
	<u>50,000</u>		<u>50,000</u>

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) <u>2,000</u>
	15,000
Less: Reduction in general provision (N16,000 – N15,000)	(c) (1,000)
Charged in statement of profit or loss	<u>14,000</u>

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 31/12/24:

	₦
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	<u>(59,000)</u>
Statement of profit or loss	<u>83,500</u>
	=====

	₦		₦
Bad debt written off	70,000	Bal b/f	18,000
		Bad debt recovered	59,000
Bal c/d (Specific provision)	<u>48,000</u>	Stat. of profit or loss	<u>41,000</u>
	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	<u>(41,000)</u>
Amount to be added back	<u>42,500</u>

Donations

CITA Section 21 stipulates, among other things, the conditions to be satisfied before any donation can be allowed. These are:

- 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;
- 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.

5.3.1 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 Federal or State Government, including university teaching hospitals, or any hospital operated by a society or association not established for the purpose of generating profits or distributing gains to its individual members, is exempt from taxation.

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) Paterson Zochonis Nigeria Technical Education Trust Fund
- (i) 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 Trypanosomiasis 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.

5.4 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 transaction;
- (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.

5.5 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.

5.6 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:

- (i) some income chargeable might have been omitted, for example, investment income, undisclosed revenue, etc.;
- (ii) some income not chargeable might have been included, for example, franked investment Income [dividend], profit on disposal of company's assets/investments etc.;
- (iii) some expenses allowable as deductions might have been omitted due to errors, or mistakes;
- (iv) some expenses not allowable as deductions might have been deducted, for example, 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

	N	N
Net profit per accounts		X
Add:		
Expenditure charged in the account which is not deductible	X	-
Income taxable which has not been Included	<u>X</u>	<u>X</u>
		X
Less:		
Profits included in the accounts but which are not taxable	X	
Expenditure which is deductible but which has not been charged in the accounts	<u>X</u>	<u>X</u>
Profit adjusted for tax purposes		<u><u>XX</u></u>

5.7 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, a large corporate entity, generated a profit of ₦2,000,000 during the year ended December 31, 2024. 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:

$$\frac{\text{N}1,400,000}{\text{N}1,400,000 + \text{N}600,000} \times \text{N}250,000 \\ = \text{N}175,000$$

5.8 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 more than 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.

5.9 Concepts of connected persons and debts

- (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, a large organisation, was incorporated on November 2, 2011, and it commenced operations 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, 2024, revealed the following:

	N
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 2025 assessment year

Computation of earnings before interest, taxes, depreciation and amortisation (EBITDA)

	N	N
Assessable profit		1,000,000
Add:		
Interests deducted	1,250,000	
Depreciation	<u>300,000</u>	<u>1,550,000</u>
EBITDA		<u>2,550,000</u>
Interest deductible before restriction		
Interest paid to other creditors		500,000
Interest paid to ABC (Canada) Limited		<u>750,000</u>
Total interest expenses		1,250,000
Interest for tax exempt profit		<u>(200,000)</u>
Interest qualifying for deduction		<u>1,050,000</u>

Restriction:

$$30\% \text{ of EBITDA (30\% of ₦2,550,000)} = \underline{\text{₦765,000}}$$

Amount of interest deductible in 2025 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.

5.10 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.

5.11 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.

5.12 Chapter review

This chapter explains the reasons for profit adjustments, allowable and non- allowable items of income and expenditures, specific allowance (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.

5.13 Worked examples

5.13.1 Questions

1. Shine Your Eye (SYE) Limited is a company which has been in business for many years. The operating results for the year ended December 31, 2024, are as follows:

	₦'000	₦'000
Turnover		85,000

Less: Expenses

Purchase	45,000	
Transport and traveling	6,000	
Salaries and wages	7,000	
Fines and traffic offence	100	
Donations	1,800	
Audit fees	1,000	
Rent	1,600	
Depreciation	2,400	
Expenses on increase in share capital	50	
Education tax provision	600	
Printing and stationery	2,520	
Legal fees	940	
Defalcations and embezzlement	<u>400</u>	<u>69,410</u>
Net profit		<u>15,590</u>

Other relevant details:

- (i) Agreed capital allowance is ₦1,800,000
- (ii) 25% of the donation was expended on hiring a first-class musician to play at the birthday party of the company's chairman, Chief Mustapha.
- (iii) Included in rent was ₦288,000 paid to a landlord, in whose house the MD's cousin, Miss Charity, resides.
- (iv) The MD perpetrated 50% of the defalcation.
- (v) Legal fees is made up of:

	₦'000
Legal fee paid on long lease	500
Legal fee paid on short lease	200
Retainership on short lease	<u>240</u>
	<u>940</u>

Required:

Compute the adjusted profit of SYE Limited for the relevant year of assessment.

2. 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, 2024:

	₦	₦
Gross profit		1,230,936
Miscellaneous income		<u>31,440</u>
		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	
Allowance for 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	
		<u>1,047,180</u>
Net profit		215,196
		=====

You are given the following additional information:

(i) Allowance for bad and doubtful debts consists of:

General provision	12,000
Specific provision	27,100

Bad debts written off	6,500
Bad debts recovered	<u>(5,060)</u>
	<u>40,540</u>

(ii) Defalcation and embezzlement

A director defrauded the company to the tune of ₦40,000. The other embezzlements were committed by junior staff.

(iii) Miscellaneous income includes: ₦

Profit on disposal of PPE	8,690

(iv) Legal and professional charges include:

Debt collection	6,000
Renewal of short leases	2,400
Defense for traffic offence	1,500
Land acquisition	15,000
Retainership fee	<u>6,000</u>
	<u>30,900</u>

(v) Miscellaneous expenses comprise:

Court fine	2,400
Exchange loss on translation of intercompany balance	25,140
Exchange loss on remittance	6,500
Office expenses	<u>10,800</u>
	<u>44,840</u>

(vi) Donations and subscriptions comprise:

Lagos Chambers of Commerce	3,000
Motor Boat Club	1,200

Polo Club	1,000
Political parties	30,000
National Relief Fund	<u>2,000</u>
	<u>37,200</u>

Required:

Compute adjusted profit for the relevant assessment year.

3. 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, 2023, is as follows:

	₦	₦
Sale of Log. plywood etc		2,320,586
Inventory - 31-07-2022	1,140,796	
Inventory - 31-07-2023	<u>(721,058)</u>	
	419,738	
Cost of sale of imported	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	
Technical school expenses and 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	<u>67,200</u>	<u>1,847,156</u>
Profit for the year		<u>474,190</u>

Note:

(i) Included in donations and subscription are:

Institute of Chartered Accountants secretariat's project	~~N~~ 5,000
Sports Council	~~N~~ 400
Various other charitable donations to Island Club, Supreme Executive circle and kaukaus Club of Nigeria (each)	~~N~~ 3,000

(ii) Advertising includes a specific provision against impending international trade fair in which the company was to participate ~~N~~50,000

(iii) In arriving at the figures for bad debts, individual assessment of the debts was made

(iv) Technical school expenses item is made up of the various amounts spent on furniture and equipment for the school building just completed.

(v) Legal and professional fees include ~~N~~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.

4. 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.

5.13.2 Suggested solutions to questions

1.

Shine Your Eye Limited		
Computation of Adjusted Profit		
For the year ended December 31, 2024 (2025 assessment year)		
	₦'000	₦'000
Net profit as per accounts		15,590
Add: Disallowable items:		
Fines and traffic offence	100	
Depreciation	2,400	
Expenses on increase in share capital	50	
Education tax for provisions	600	
Donation (25% of ₦1,800)	450	
Rent	288	
Defalcation (50% of ₦400)	200	
Legal fees (₦500 + ₦200)	<u>700</u>	<u>4,788</u>
Adjusted profit		<u>20,378</u>

(2)

Mohammed Limited

Computation of adjusted profit

For the year ended Nov 30, 2024 (2025 assessment year)

	₦	₦
Net profit per accounts		215,196
Add:		
Depreciation	171,300	
General allowance 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	<u>25,140</u>	<u>259,540</u>
		474,736
Deduct:		
Profit on sale of property, plant and equipment		<u>(8,690)</u>
Adjusted profit		<u>466,046</u>

(3)

Olowojeunjeje Plc.

Computation of adjusted profit

For year ended July 31, 2023 (2024 assessment year)

	₦	₦
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	<u>102,600</u>	<u>241,076</u>
Adjusted profit		<u>715,266</u>

Note:

Charitable Donations

Section 25 of CITA 2004 (as amended) and the Fifth Schedule to the Act, specifically listed bodies to which companies can donate fund. Outside this list, donations shall be disallowed. Consequently, charitable donations of N3,000 being general has been disallowed.

4. 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:
- (i) 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
 - (ii) 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
 - (iii) 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

- Donations must be made to any of the funds, bodies, institutions in Nigeria contained in the Fifth schedule to CITA.
- 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.
- Donations must not be of a capital nature except donation to a university or other tertiary or research institutions.
- 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.
- 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:

- the cost of in-kind donations made to the Government and any designated agency shall be allowed as deductions; or
- 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.

- 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.

LOSS RELIEF

Contents

- 6.0 Learning objective
- 6.1 Learning outcomes
- 6.2 Introduction
- 6.3 Rules governing loss relief
- 6.4 Current year loss relief
- 6.5 Carry forward loss relief
- 6.6 Terminal loss relief
- 6.7 Chapter review
- 6.8 Worked examples

6 Loss Relief

6.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the treatment of loss relief in Nigeria.

6.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

- (a) know the characteristics of relevant loss relief procedure;
- (b) understand 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.

6.2 Introduction

A company makes a loss from its trade or business when its 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.

6.3 Rules governing loss relief

Section 27 of the Companies Income Tax Act, 2004 (as amended) contains the provisions applicable to losses incurred by companies. Essentially, these are:

- (a) the amount of loss to be allowed should be that which the Revenue Service is satisfied with 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 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.

6.4 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. 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's 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.

6.5 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 relievably 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.

6.6 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 unutilised 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)).

6.7 Chapter review

This chapter defines what constitutes a loss for a company in trade or business and 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 can benefit from this relief. In addition, readers must know the features and characteristics of carry forward loss relief applicable to the corporate taxpayers.

6.8 Worked examples

6.8.1 Questions

1. Colanin Manufacturing Company Limited was incorporated in September, 2010 for the purpose of production of quality textile and garment materials. The company, however, commenced business on January 1, 2011. Its accounting date is 31 December each year.

The company presented the following operational results:

Trading periods	Adjusted profits/(losses)
	~~R~~
Year ended 31/12/19	(10,000,000)
Year ended 31/12/20	3,000,000
Year ended 31/12/21	2,500,000
Year ended 31/12/22	2,000,000
Year ended 31/12/23	1,500,000
Year ended 31/12/24	(3,200,000)

Required:

Compute the assessable profits for the relevant years.

2. 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.

3. Olympus Nigeria Limited, Abeokuta, is into manufacturing of soaps and detergents. In its last management meeting, the Managing Director was of the opinion that the company having made a loss of N10,750,000 during the year ended December 31, 2020, the company ordinary would have enjoyed some tax rebates from the Federal Inland Revenue Service (FIRS). It was then recommended that a topnotch tax consultant should be pointed out to review the company's financials and tax payments in the last few years.

The company has just appointed you as its Tax Consultant, with the sole mandate of reviewing its tax computations for some relevant years of assessment

The following details were provided by the company's Financial Accountant:

- (a) Analysis of turnover and adjusted profit/(loss)

Year ended December 31	Turnover ₦	Adjusted profit/(loss) ₦
2020	90,980,000	(10,750,000)
2021	124,200,000	2,400,000
2022	110,600,000	3,100,000
2023	170,300,000	4,700,000
2024	195,250,000	6,360,000

- (b) Capital allowances as agreed with the FIRS:

Tax year	Amount ₦
2020	1,180,000
2021	1,200,000
2022	2,500,000
2023	1,800,000
2024	3,650,000
2025	3,900,000

Required:

As the company's Tax Consultant, you are to prepare a report for the attention of the company's Managing Director showing the company's tax liabilities for all the relevant assessment years.

6.8.2 Suggested solutions to questions

1.

Colanin Manufacturing Company Limited**Computation of assessable profits**

For 2020 – 2025 tax years

	~~£~~	~~£~~
2020 tax year		
Basis period 1/1/19 - 31/12/19		
Loss for the year ended 31/12/19		(10,000,000)
Loss relieved		<u>Nil</u>
Unrelieved loss c/f		<u>(10,000,000)</u>
Assessable profit		<u>Nil</u>
2021 tax year		
Basis period 1/1/20 - 31/12/20		
Adjusted profit for the year ended 31/12/20		3,000,000
Unrelieved loss b/f	(10,000,000)	
Loss relieved	<u>3,000,000</u>	<u>(3,000,000)</u>
Unrelieved loss c/f	<u>(7,000,000)</u>	
Assessable profit		<u>Nil</u>
2022 tax year		
Basis period 1/1/21 - 31/12/21		
Adjusted profit for the year ended 31/12/21		2,500,000
Unrelieved loss b/f	(7,000,000)	
Loss relieved	<u>2,500,000</u>	<u>(2,500,000)</u>
Unrelieved loss c/f	<u>(4,500,000)</u>	
Assessable profit		<u>Nil</u>

2023 tax year

Basis period 1/1/22 - 31/12/22		
Adjusted profit for the year ended 31/12/22		2,000,000
Unrelieved loss b/f	(4,500,000)	
Loss relieved	<u>2,000,000</u>	<u>(2,000,000)</u>
Unrelieved loss c/f	<u>(2,500,000)</u>	
Assessable profit		<u>Nil</u>

2024 tax year

Basis period 1/1/23 - 31/12/23		
Adjusted profit for the year ended 31/12/23		1,500,000
Unrelieved loss b/f	(2,500,000)	
Loss relieved	<u>1,500,000</u>	<u>(1,500,000)</u>
Unrelieved loss c/f	<u>(1,000,000)</u>	
Assessable profit		<u>Nil</u>

2025 tax year

Basis period 1/1/24 - 31/12/24		
Loss for the year ended 31/12/234		(3,200,000)
Unrelieved loss b/f		<u>(1,000,000)</u>
Total loss available for relief		<u>(4,200,000)</u>
Loss relieved		<u>Nil</u>
Unrelieved loss c/f		<u>(4,200,000)</u>
Assessable profit		<u>Nil</u>

Note:

- (i) Colanin Manufacturing Company Limited is allowed to carry forward unrelieved losses indefinitely and recoup same against future profits.
- (ii) Readers are not required to compute the tax liability as it is the computation of assessable profits that is required in the question.

2. 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 loss to be allowed should be that which the Revenue Service is satisfied with 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 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; and
- (e) the loss available for relief should be computed on the same basis as that of assessable profit for a year of assessment.

3.

Owo-Ru & Co (Tax Consultants)
Praise Road, Ijebu-Ode

Date:

The Managing Director
Olympus Nigeria Limited
Abeokuta

Dear Sir,

RE: Computations of Tax Liabilities for the Relevant Assessment Years

We refer to your request on computation of tax liabilities for 2021, 2022, 2023, 2024 and 2025 assessment years. Our comments are as follows:

The attached appendix 1 presents the report of the companies income tax and tertiary education tax payable for 2021 through 2025 assessment years.

We hope this report adequately represents the mandate given to us. Should you require further clarification, we will be glad to address it.

Yours faithfully,

Oye Oworu

Appendix 1: Computation of tax liabilities For 2021 – 2025 tax years

	N	N
2021 tax year		
Basis period 1/1/20 - 31/12/20		
Loss for the year ended 31/12/20		(10,750,000)
Loss relieved		<u>Nil</u>
Unrelieved loss c/f		(10,750,000)
Capital allowance for the year	1,200,000	
Capital allowance utilised	<u>Nil</u>	<u>Nil</u>
Unutilised capital allowance c/f	1,200,000	
Total profit		<u>Nil</u>
Companies income tax @ 20%		<u>Nil</u>
Tertiary education tax @ 2 of adjusted profit		<u>Nil</u>
2022 tax year		
Basis period 1/1/21 - 31/12/21		
Adjusted profit for the year ended 31/12/21		2,400,000
Unrelieved loss b/f	(10,750,000)	
Loss relieved	<u>2,400,000</u>	(2,400,000)
Unrelieved loss c/f	<u>(8,350,000)</u>	
Capital allowance for the year	2,500,000	
Unutilised capital allowance b/f	<u>1,200,000</u>	
Total capital allowances available for utilisation	3,700,000	
Capital allowance utilised	<u>Nil</u>	<u>Nil</u>
Unutilised capital allowance c/f	<u>3,700,000</u>	
Total profit		<u>Nil</u>
Companies income tax @ 30%		<u>Nil</u>
Tertiary education tax @ 2.5% of N2,400,000		<u>60,000</u>
2023 tax year		
Basis period 1/1/22 - 31/12/22		
Adjusted profit for the year ended 31/12/22		3,100,000
Unrelieved loss b/f	(8,350,000)	
Loss relieved	<u>3,100,000</u>	(3,100,000)
Unrelieved loss c/f	<u>(5,250,000)</u>	
Capital allowance for the year	1,800,000	
Unutilised capital allowance b/f	<u>3,700,000</u>	

Total capital allowances available for utilisation	5,500,000	
Capital allowance utilised	<u>Nil</u>	<u>Nil</u>
Unutilised capital allowance c/f	<u>5,500,000</u>	

Total profit		<u>Nil</u>
Companies income tax @ 30%		<u>Nil</u>
Tertiary education tax @ 2.5% of N3,100,000		<u>77,500</u>

2024 tax year

Basis period 1/1/23 - 31/12/23

Adjusted profit for the year ended 31/12/23		4,700,000
Unrelieved loss b/f	(5,250,000)	
Loss relieved	<u>4,700,000</u>	(4,700,000)
Unrelieved loss c/f	<u>(550,000)</u>	

Capital allowance for the year	3,650,000	
Unutilised capital allowance b/f	<u>5,500,000</u>	
Total capital allowances available for utilisation	9,150,000	
Capital allowance utilised	<u>Nil</u>	<u>Nil</u>
Unutilised capital allowance c/f	<u>9,150,000</u>	

Total profit		<u>Nil</u>
Companies income tax @ 30%		<u>Nil</u>
Tertiary education tax @ 3% of N4,700,000		<u>141,000</u>

2025 tax year

Basis period 1/1/24 - 31/12/24

Adjusted profit for the year ended 31/12/24		6,360,000
Unrelieved loss b/f	(550,000)	
Loss relieved	<u>550,000</u>	(550,000)
Unrelieved loss c/f	<u>(550,000)</u>	
		5,810,000
Capital allowance for the year	3,900,000	
Unutilised capital allowance b/f	<u>9,150,000</u>	
Total capital allowances available for utilisation	13,050,000	
Capital allowance utilised	<u>(5,810,000)</u>	<u>5,810,000</u>
Unutilised capital allowance c/f	<u>7,240,000</u>	

Total profit		<u>Nil</u>
Companies income tax @ 30%		<u>Nil</u>
Tertiary education tax @ 3% of N6,360,000		<u>190,800</u>

ICAN 2025

CAPITAL ALLOWANCES

Contents

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- 7.12 Capital allowances on commencement of business – Finance Act, 2019

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- 7.14 Computation of capital allowances where there is cessation of business – Finance Act, 2019
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7 Capital Allowances

7.0 Learning objective

The objective of this chapter is to enhance readers' understanding of principles and practice of capital allowances in Nigeria.

7.1 Learning outcomes

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.

7.2 Introduction

The provision for capital allowances is as contained in the Second Schedule to the CITA 2004 (as amended). 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.

7.3 Definitions and types of capital allowance

7.3.1 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.

7.3.2 Initial allowance

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 regards the number of months in the basis period of a relevant tax year. For example, an initial allowance of ~~N~~25,000 will be claimed for a qualifying expenditure amounting to ~~N~~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).

7.3.3 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 N6,250, that is, 25% of (N50,000 – N25,000). 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.

7.4 Balancing allowance and balancing charge

7.4.1 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.

7.4.2 Balancing charge

Where the sales value of an asset exceeds 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 claims.

This is a claw back of capital allowances previously enjoyed by the company and should not exceed the reliefs given.

7.5 Capital allowance rates and restrictions under CITA

The following are the capital allowances rate:

	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: An annual allowance of 90 per cent with 10 per cent retention, for investment in plant and machinery, 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.

7.6 Qualifying capital expenditure

Qualifying capital expenditure means expenditure incurred on an asset 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:

- (a) 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 recognised 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.

7.7 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 purposes, 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.

7.8 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.

7.9 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:

- (i) 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.

7.10 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:

- (i) The establishment or management of plantations to produce 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, 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 computation of the company's profit from its trade or business cannot be treated as qualifying capital expenditure.

7.11 Calculation of capital allowances on assets acquired on hire purchase

A company or an individual taxpayer wanting to preserve liquid funds or that fall short of it may elect to enter into hire purchase agreement. Such agreement usually flexes the payment which is made in instalments. Since payment is made in piece meal, such arrangement will attract some interest 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.

7.12 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.

7.13 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.

7.14 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 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.

7.15 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 capital allowances on capital expenditure

when it crosses the threshold of N25m as it will now qualify as either a medium or large company.

7.16 Carry back 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.

7.17 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 able 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 at the date of cessation of business is expected to be well comprehended.

7.18 Worked examples

7.18.1 Questions

1. On September 1, 2014, Idiaraba Limited entered into a hire purchase agreement with Idiarere Limited. Ten (10) generators were 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 prepares its accounts to June 30, every year.

Required:

Compute the capital allowances 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 affected in the year ended June 30, 2014.

	N
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 ~~N~~2million. The residues of qualifying expenditure as at July 1, 2013, were:

	N
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 N2,000,000 on furniture and Fittings in 2020 assessment year when the revenue of the company was N24,000,000. The company achieved revenue of N27,000,000 in 2023 assessment year.

Required:

Compute the capital allowances claimable for all the relevant years of assessment.

7.18.2 Suggested solution to 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 (N)
2016	Cost	3,200,000			1,600,000
	I.A	1,600,000			<u>400,000</u>
	A.A	<u>400,000</u>			<u>2,000,000</u>
	TWDV	<u>1,200,000</u>			
2017	Cost		1,800,000		

	I.A		900,000		900,000
	A.A	<u>400,000</u>	<u>300,000</u>		<u>700,000</u>
					<u>1,600,000</u>
2018	TWDV	800,000	600,000		
	Cost			600,000	
	I.A			300,000	<u>300,000</u>
	A.A	<u>400,000</u>	<u>300,000</u>	<u>150,000</u>	<u>850,000</u>
					<u>1,150,000</u>
2019	TWDV	4000,000	300,000	150,000	
	A.A	<u>400,000</u>	<u>300,000</u>	<u>149,900</u>	<u>849,900</u>
		<u>0</u>	<u>0</u>	<u>100</u>	

Working Notes:

- i. Principal for capital allowance ~~N~~

Deposit	2,000,000	
Installment (24 x 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	<u>50,000</u>	
Principal (200,000 – 50,000)	<u>150,000</u>	
- ii. Schedule of payment

Tax year	Basis period	No of instalment	Amount
2016	1/7/14 – 30/6/15	8	1,200,000
Deposit			<u>2,00,000</u>
			<u>3,200,000</u>
2017	1/7/15 – 30/6/16	12	<u>1,800,000</u>
2018	1/7/16 – 30/6/17	4	<u>600,000</u>
- iii. 2016 Annual allowance

Annual allowance	<u>=3,200,000 – 1,600,000</u>	= ~~N~~ 400,000
	4	
- iv. 2017 Annual allowance

(i) Annual allowance	= <u>1,200,000</u>	= ~~N~~ 400,000
	4 – 1	
(ii) Annual allowance	= <u>1,800,000 – 900,000</u>	= ~~N~~ 300,000
	4 – 1	
- v. 2018 Annual allowances = TWD/unexpired tax life

(i) Annual allowance	= 800,000/2 = ~~N~~ 400,000

- (ii) Annual allowance = $600,000/2 = \text{N}300,000$
 (iii) Annual allowance = $300,000/2 = \text{N}150,000$
- vi. 2019 Annual allowances TWDV/Unexpired tax life
 (i) Annual allowance = $400,000/1 = \text{N}400,000$
 (ii) Annual allowance = $300,000/1 = \text{N}300,000$
 (iii) Annual allowance = $(150,000/2) \text{ less } \text{N}100,000 = \text{N}149,900$

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 ₦'000	Non-Plant & machinery ₦'000	Motor vehicles ₦'000	Total allowances ₦'000
Residue b/f	10,000	2,000	3,000	
Disposal at WDV	-	-	375	
Net residue (A)	10,000	2,000	<u>2,625</u>	
Additions:	5,000	1,750	3,500	
Investment allow.		175		
Initial allow.	<u>750</u>	<u>875</u>	<u>1,750</u>	<u>3,375</u>
Balance after initial allow (B)	<u>4,250</u>	<u>875</u>	<u>1,750</u>	
	₦	₦	₦	₦
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)	<u>11,825</u>	<u>1,656</u>	<u>2,624</u>	

WDV of disposal 2013 Assessment year Motor vehicle cost

Year end 30/6/2012	1,500,000
Less: Initial allowance	<u>750,000</u>
Balance after initial allowance	750,000
Annual allowance	<u>187,500</u>
Tax written down value of disposal	<u>375,000</u>

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	<u>375,000</u>
Surplus	<u>1,625,000</u>

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

(3) Conditions for granting capital allowances

Capital allowances are granted if the following conditions are satisfied:

- The company claiming the allowance must be the owner of the assets at the end of its basis period for a year of assessment;
- 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. 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:

- (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, poultry, piggery, cattle rearing, fish farming, and deep sea fish-trawling”; and
- (iv) 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		Remarks
		Total capital allowances	Cost	
		₦	₦	
Initial allowance - 25%				
Annual allowance – 20%				
<u>Assessment year 2020</u>				
Cost			2,000,000	
Initial allowance	500,000			
Annual allowance	300,000	800,000		
<u>Assessment year 2021</u>				
Annual allowance	300,000	1,100,000		
<u>Assessment year 2022</u>				
Annual allowance	300,000	1,400,000	<u>(1,400,000)</u>	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 ~~N~~500,000 (25%) and the annual allowance of ~~N~~300,000 (~~N~~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 ~~N~~2,000,000 less ~~N~~500,000 (I.A), less ~~N~~900,000 (A.As for 3years), which equals ~~N~~600,000.

The capital allowances claimable in A.Y. 2023 is ~~N~~300,000, whilst that of A.Y. 2024 is ~~N~~299,990, that is ~~N~~300,000 less retention of ~~N~~10.

ASSESSABLE PROFIT AND TOTAL PROFIT

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8 Assessable Profit and Total Profit

8.0 Learning objective

The objective of the chapter is to enhance readers' understanding of computations of assessable profit and total profit.

8.1 Learning outcomes

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) know the objectives of Tertiary Education Trust Fund (Establishment) Act 2011;
- e) compute minimum tax;
- f) compute total profit;
- g) understand the basis of computing companies income tax;
- h) know other bases of computing companies income tax; and
- i) compute companies income tax.

8.2 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.

8.3 Concepts of adjusted/assessable profit and total profit

8.3.1 Adjusted profit/assessable profit.

Adjusted profit is determined by taking 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.

8.3.2 Total profit

Total profit is arrived at after the deduction of loss relief and the granting of capital allowance from adjusted profit.

8.4 Format of computations of 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	<u>XXX</u>
		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)	<u>XX</u>	<u>XXX</u>
Assessable profit (AP)		XXX
Less: Loss relief (Sec. 27)		<u>XXX</u>
		XXX
Add: Balancing charge (Schedule 2)		XXX
Less: Investment allowance (Sec. 28)		<u>XXX</u>
		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)	<u>(XX)</u>	<u>(XX)</u>
Capital allowance c/f	<u>XX</u>	
Total profit (TP)		<u>XXX</u>
Companies income tax payable, using applicable rates based on total profit, excluding small companies		XXXX
Tertiary education tax payable (3% of AP), except small companies		<u>XXXX</u>
Total tax payable		<u>XXXX</u>

8.5 Tertiary education tax

8.5.1 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 to involve 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.

8.5.2 Basis of computation

The rate of tertiary education tax is 3 percent of the assessable profit of a company registered in Nigeria (Section 26 of Finance Act 2023). 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.

8.5.3 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 be 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.

8.5.4 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.

8.5.5 Composition and functions of the Board of Trustees

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 the Board of 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 Minister of Education 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 demands.

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.

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.

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 N2,000,000 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	<u>610</u>

Required:

Compute assessable profit and tertiary education tax for the relevant year of assessment.

Suggested solution to illustration

Zepon Limited

Computation of adjusted profit and tertiary education tax For 2014 Assessment year

	₦'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	<u>180</u>	<u>1,180</u>
Assessable profit		<u>2,670</u>
Tertiary education tax liability (3% of assessable profit)		<u>80.10</u>

Profit as per accounts		1,490
Add back disallowable expenses:		
Depreciation	610	
Provision for general bad debts	390	
Stamp duty on increase in capital	<u>180</u>	<u>1,180</u>
Assessable profit		<u>2,670</u>

8.6 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 (that is, companies with less than ₦1,000,000 turnover) that are taxed at reduced rate of 20%.

The Finance Act, 2019, 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%

The Implications of classification of Nigerian companies 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.

8.7 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.

8.8 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

8.8.1 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, 2024, 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	<u>1,100,000</u>	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	<u>4,700,000</u>	4,700,000

Required:

Compute the minimum tax payable.

Solution to illustration 8.2

Based on the provisions of the Finance Act, 2020, the minimum tax payable is computed thus:

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	<u>39,150,000</u>
Dividend received from APD Limited (franked investment income)	<u>(2,400,000)</u>
Gross turnover for the computation of minimum tax	<u>36,750,000</u>

The minimum tax payable is $0.25\% \times \text{N}36,750,000 = \text{N}91,875$

8.8.2 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

Igbogbo (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 2024.

	₦ '000
Revenue	100,000
Assessable profit	5,850
Balancing charge	<u>500</u>
	6,350
Less	
Unrelieved loss brought forward	<u>1,200</u>
	5,150
Capital allowance	(2,500)
Total profit	2,650
Companies income tax payable	
₦2,650,000 at 30%	<u>₦795,000</u>

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 2024 Assessment year. (ignore minimum tax computation).

Solution to illustration 8.3

Igbogbo (Nigeria) limited

Computation of companies income tax liability Assessment year 2024

	₦'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	<u>23,050</u>
Companies income tax payable	
N23,050,000 at 30%	<u>₦6,915,000</u>

8.8.3 Dividend basis – Section 19 CITA

Prior to Finance Act, 2019, the provisions of Section 19 of CITA were 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 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/Petroleum Industry Act,) or the Capital Gains Tax Act (CGTA);
 - (b) dividends paidout 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 and 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 ~~N~~4,200,000 paid by ABC Limited, only ~~N~~600,000 can be regarded as having been paid out of retained earnings, hence only ~~N~~3,600,000 shall be subject to the application of section 19(1) of CITA.
- (b) ~~N~~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).

8.8.4 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 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.

8.8.5 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.

8.9 Anti-abuse

Any attempt by a company to split the transactions that were carried out prior to the commencement of the Finance Act, 2019 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.

8.10 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.

8.11 Worked examples

8.11.1 Questions

1. Colends Nigeria Limited, is a private limited liability company which has been in business successfully for many years. The following is the summary of its profit or loss accounts for the year ended December 31, 2024.

Colends Nigeria Limited	
Statement of profit or loss	
For the year ended December 31, 2024	
	₦'000
Gross profit b/f	89,694
Profit on sale of investment	96
Dividend received (gross)	<u>2,000</u>
	91,790

Less: Expenses:		
Audit fee	140	
Loan interest	400	
Bad debts	250	
Depreciation	3,125	
General expenses	1,000	
Carriage	400	
Lighting	850	
Salaries and wages	20,000	
Rent and rates	2,500	
Repairs and maintenance	800	
Staff welfare	2,000	
Telephone/postage	3,000	
Motor running expenses	4,200	
Travelling expenses	2,100	
Donations	<u>1,025</u>	<u>41,790</u>
Net profit		<u>50,000</u>

The following additional information is available:

(i)	Bad debts		
		N'000	
	Employee's loan written off	120	
	General provision	100	
	Specific debts	170	
	Debts recovered	<u>(140)</u>	
		<u>250</u>	
(ii)	General expenses are made up as follows:		
		N'000	N'000
	Sundry expenses (allowable)		290
	Luncheon vouchers		294
	Subscription:		
	Trade	80	
	Social club	<u>96</u>	176
	Printing		80
	Legal cost:		
	Lease on new premises	120	
	Customer's claim on defective goods	<u>40</u>	<u>160</u>
			<u>1,000</u>

	N'000
(iii) Repairs and maintenance consists of:	
Decoration of new premises	360
Repairs to plant	100
Renovation of old factory	<u>340</u>
	<u>800</u>
(iv) The loan interest shown in the profit and loss account is the interest on loan to a friend of one of the directors of the company. This friend is very useful as a link in the procurement of a lucrative contract by the company.	
(v) Donations comprise:	
	N'000
Political parties	300
Royal Elites Klub	500
Boy's Scout of Nigeria	125
Society for the blind	<u>100</u>
	<u>1,025</u>
(vi) Capital allowance as agreed with the tax authorities is N3,074,000	

Required:

Compute the:

- (a) Adjusted profit; and
- (b) Income tax liability for 2025 assessment year

2. Empire Nigeria Limited is owned by Nigerians and has been in business since year 2003. The results of the company as at December 31, 2023, are as follows:

Assets employed	N	N
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, 2023 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 2023 year of assessment was ₦600,000.
- (v) Capital allowances for 2024 year of assessment amounted to ₦950,000.

Required:

- (a) Compute the company's minimum tax liability for 2024 year of assessment.
- (b) Compute the company's income tax liability for 2024 year of assessment.

Note: Ignore restriction on capital allowance that can be relieved.

3. 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 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.

Required:

Discuss 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.

4. 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, 2024:

	₦'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 N60million.
- (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.

Required:

As the tax consultant to the board of CHC, **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

8.11.2 Suggested solutions to questions

(1) (a)

Colends Nigeria Limited
Computation of adjusted profit
For year ended December 31, 2024

	₦'000	₦'000
Net profit as per accounts		50,000
Add back: Disallowable items		
Loan interest	400	

Bad debt:			
Employee's loan	120		
General provision	<u>100</u>	220	
General expenses:			
Subscription (social club)	96		
Legal cost (lease)	<u>120</u>	216	
Depreciation		3,125	
Repairs and maintenance:			
Decoration to new premises		360	
Donation:			
Political parties	300		
Royal Elites Klub	<u>500</u>	<u>800</u>	<u>5,121</u>
			55,121
Deduct:			
Dividend received (gross)		2,000	
Profit on sale of investment		<u>96</u>	
			(2,096)
Adjusted profit			<u>53,025</u>

(b)

Colends Nigeria Limited
Computation of income tax liability
For 2025 assessment year

	₦'000
Adjusted profit	53,025
Less: Capital allowances	<u>3,074</u>
Total profit	<u>49,951</u>
Companies income tax @ 30%	14,985.3
Tertiary education tax @ 3% of adjusted profit (3% of ₦53,025)	<u>1,590.75</u>
Total tax liability	<u>16,576.05</u>

(2) (a)

Empire Nigeria Ltd
Computation of minimum tax liability
For 2024 year of assessment

	N
Turnover	<u>240,000,000</u>
Minimum tax thereon @0.25%	600,000

(b) **Computation of companies income tax liability**

2024 Assessment year

	N	N
Assessable profit		2,100,000
Deduct		
Unrelieved capital allowances b/f	600,000	
Current year capital allowance	<u>950,000</u>	<u>(1,550,000)</u>
Total profit		<u>550,000</u>
Companies income tax (30% of N550,000)		165,000
Tertiary education tax (3% of N2,100,000)		<u>63,000</u>
Total tax liability		<u>228,000</u>

(3) XYZ & Co. (Chartered Accountants)

May 18, 2025
The Managing Director
Boling Nigeria Limited
Airport Road, Gombe
Gombe State

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, 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 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)

Bala Musa

Managing Partner

(4) (a) The tax implications of the dividend paid by the board

- It is evident that the dividend paid (N165,000,000) is more than the total profit (NIL). What was paid as dividend was the dividend income of N105,000,000 and the profit from sale of property, plant and equipment of N60,000,000.
- 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.
- Based on point noted above, the dividend income (N105,000,000) is not to be subjected to further tax.
- The balance of N60,000,000 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 ~~N~~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,
XYX & CO.

S.T.Akinyele
Managing
Partner

(b) **Compass Holding Company (CHC)**
Computation of tax liability
For 2025 tax year

	₦'000	₦'000
Net profit per accounts		107,000
Add back:		
Depreciation	18,500	
Donations	12,500	
Diminution in investment	25,000	
Bad debt provision	<u>32,000</u>	<u>88,000</u>
		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	<u>105,000</u>	<u>(170,200)</u>
Assessable profit		24,800
Add: Balancing charge		<u>5,200</u>
		30,000
Less: Loss relief		<u>(15,200)</u>
		14,800

Less: Capital allowance	22,300	
Limited to 2/3 of N24,800	<u>14,800</u>	14,800
Unabsorbed capital allowances c/f	<u>7,500</u>	<u> </u>
Total profit		<u>NIL</u>
Tax payable (Please see comment a(i) above)		NIL
Tertiary education tax payable @ 3% of N24,800,000	=	<u>744,000</u>

TAXATION OF INVESTMENT INCOME

Contents

- 9.0 Learning objective
- 9.1 Learning outcomes
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- 9.3 Dividend income
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- 9.6 Rental income
- 9.7 Chapter review
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9. Taxation of investment income

9.0 Learning objective

The objective of this chapter is to enhance readers' understanding of taxation of investment income in Nigeria.

9.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

- (a) understand the basis of assessment of investment income;
- (b) appreciate the treatment of dividend income in Nigeria;
- (c) understand the treatment of interest income in Nigeria;
- (d) know the treatment of royalty income in Nigeria;
- (e) ascertain the treatment of rental income in Nigeria; and
- (f) know how to compute the tax liability of persons/entities earning investment income.

9.2 Basis of assessment of investment income

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.

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.

The provisions of Section 23(1)(n) of the Companies Income Tax Act, CAP C21, LFN, 2004 clearly states that "nothing in this section shall be construed to exempt from deduction at source, the tax which a company making payments is to deduct under Sections 78, 79 or 80 of this Act ... shall apply to a dividend, interest, rent or royalty, which is a part of the profits or income referred to in subsection (1)(a) to (f) and (h) to (i) of this Section". The reference to 'company' in the law means any company or corporation, established by or under any law in force in Nigeria or elsewhere and it is on a "company" that the duty to deduct withholding tax is placed, since it is the company that is making payments to various beneficiaries. The 10% withholding tax (WHT) charged on such investment incomes shall become the final tax in the hand of the beneficiary.

9.3 Dividend income

9.3.1 Definition of dividend

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. 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.

9.3.2 Payment of dividend by a Nigerian company to a Nigerian company

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. 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.

Dividend derived by a company from another company incorporated in Nigeria is exempted from tax, 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, and
- (b) 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.

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.

9.3.3 Payment of dividend by a Nigerian company to a Non-Nigerian company

Dividend income paid by a Nigerian company to a non-Nigerian company shall be exempted from tax. The amount of the withholding tax deducted in connection with such dividend due to a non-resident company shall be the final tax on those payments, that is, no further tax is payable by non-resident company of any dividend income.

Dividend income 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.

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:

- (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; and
- (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 of this section. The dividend income received by a real estate investment company on behalf of its shareholders provided that;
 - (i) a minimum of 75% of the dividend income is distributed; and
 - (ii) such distribution is made within 12 months of the end of the financial year in which the dividend income was earned;

Illustration 9.1

A company with a total profit of ₦200,000 for 2024 assessment year, paid ₦280,000 dividends to its shareholders in respect of the 2023 financial statements which formed the basis for the assessment. Determine how much the company will pay as tax?

Solution to illustration 9.1

The company will pay tax of ₦84,000. (30% of ₦280,000 and not ₦60,000 (30% of ₦200,000), assuming that the gross revenue was over ₦100 million. This is what is referred to as excess dividend tax.

9.3.4 Provisions of Finance Act, 2019 on excess dividend tax

Prior to commencement of Finance Act, 2019, companies were 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:

- (a) retained earnings on which adequate tax had previously been paid under CITA, PPTA or the CGTA;
- (b) exempt profits;
- (c) franked investment income;
- (d) dividend by a real estate investment companies (REICO) out of rental and dividend income;
- (e) the year to which the profits relate is also now irrelevant; and
- (f) the possibility of a company paying excess dividend tax is now limited.

9.3.5 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.

9.3.6 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.

9.4 Interest income

Interest income 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.

The compensating payments which qualify as 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.

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; or
- (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.

9.4.1 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.

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.

The interest on foreign currency domiciliary account in Nigeria accruing on or after 1 January 1990.

9.4.2 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.

9.4.3 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 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.

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

- i. agricultural trade or business (now limited to primary agricultural production-Finance Act, 2020). Reduction in the moratorium period to qualify the interest on loan for tax exemption from 18 months to 12 months and the rate of interest restricted to the base lending rate at the time the loan was granted, refinanced or restructured (Finance Act, 2020); or
- ii. the fabrication of any local plant and machinery; or
- iii. as working capital for any cottage industry established by the company under the Family Economic Advancement Programme (FEAP), shall be exempted

from tax, provided:

- the moratorium is not less than twelve 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.”
- 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.

Primary agricultural production is defined 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 products;
- (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 products;
- (iii) 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
- (iv) 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.

9.4.4 Provisions of Finance Act, 2019 on exemptions of 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 years	Not less than 18 months	40%
2 - 4 years	Not less than 12 months	10%
Below 2 years	Nil	Nil

9.4.5 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:

- (a) the trustees were an investment company;
- (b) the rights of the unit holders were shares in the company; and
- (c) 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 therefrom 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.

9.5 Royalty

9.5.1 Definition of 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.

9.5.2 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.

9.5.3 Royalty exempted from tax

Royalty earned from abroad and brought into Nigeria through government approved channels shall be exempt from tax. "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.

9.6 Rental income

9.6.1 Definition of 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 (that is, from day to day) over those periods covered by the payment.

9.6.2 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.

Rental income 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.

The rental income received by a real estate investment company on behalf of its shareholders provided that:

- (a) a minimum of 75% of the rental income is distributed; and
- (b) such distribution is made within 12 months of the end of the financial year in which the rental income was earned.

9.6.3 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, for example, 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.

9.6.4 Disallowable rental expenses

In computing the gain or profit from rental income for tax purposes, the following expenses are disallowable:

- (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.

9.6.5 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):

- (a) section 19 (excess dividend tax) no longer applicable to distributions by REICOs to its shareholders;
- (b) 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;
- (c) 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:

- (a) 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; and
- (b) dividend to shareholders is liable to 10% WHT deduction by REICO.

9.7 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, and how the Finance Acts, 2019 and 2020 affected the treatment of investment income (dividends, interests, rents and royalties) for tax purposes in Nigeria.

9.8 Worked examples

9.8.1 Questions

1. In the pursuit of sustainable economic development, the agricultural sector plays a pivotal role, particularly in economies where primary agricultural production forms the backbone of rural livelihoods and food security. Recognizing this importance, financial institutions, especially banks, have developed various loan and advance schemes tailored to support companies engaged in primary agricultural activities.

Required:

Discuss the incentives associated with loans and advances granted by banks to companies engaged in primary agricultural production.

- 2(a) Rental income is a significant source of earnings for many individuals and entities in Nigeria, and its treatment under tax law has important implications for both taxpayers and the government. One area of particular interest is the handling of rental income received in advance, payments made by tenants before the actual rental period begins.

Required:

Explain the provisions of the tax law in respect of rental income received in advance.

- (b) Rental income is a common source of revenue for property owners, and its taxation is governed by specific provisions under Nigerian tax law. In computing the gains or profits derived from rental income, the law recognizes that certain expenses are incurred in the process of generating this income. To ensure fair taxation and encourage accurate reporting, the tax framework allows for the deduction of specific expenses that are deemed necessary, reasonable, and directly related to the production of rental income. These deductible expenses play a crucial role in determining the net taxable income and ultimately influence the tax liability of the property owner.

Required:

Identify and explain **Five** (5) examples of expenses that can be deducted when computing rental income.

3. Mr. Emeka Godwin completed the construction of his building, a two-wing duplex located in Abuja, on December 31, 2020. He rented out both flats with effect from January 1, 2021, 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:

	2021	2022
	₦'000	₦'000
Rent received (Gross)	7,000	7,000
Expenses:		
Repairs and maintenance	440	900
Water rate	164	210
Agent's commission	700	700
Professional charges	200	300
Insurance	104	104
Caretaker's wages	36	44
Tenement rate	50	64

Additional information:

- (i) Capital allowances agreed with the relevant tax authority for 2022 and 2023 tax years were ₦960,000 and ₦240,000, respectively.
- (ii) Repairs and maintenance comprised:
- | | | |
|------------------------------|----------|----------|
| Depreciation | ₦200,000 | ₦170,000 |
| Repairs of tenant's bathroom | 0 | ₦360,000 |
| Repairs of Emeka's residence | ₦240,000 | ₦370,000 |
- (iii) Tenement rate includes tenement rate of ₦10,000 and ₦40,000 paid on the private residence of Mr. Emeka for 2021 and 2022.

Required:

Compute the amount of rental income assessable to tax for the relevant tax years.

4. Chike & Sons Limited is a company owned by the members of Chike family. Its issued share capital of 10,000,000 ordinary shares of ₦1 each are held by:

Sunday Chike	4,000,000 shares
Samuel Chike	2,000,000 shares
Joy Chike	1,000,000 shares
Mabel Chike	3,000,000 shares

Additional information:

- (i) For the year ended December 31, 2022, the company made a net profit before tax of ₦26,500,000. The company has not paid dividend since it was

established 8 years ago.

- (ii) 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 ~~N~~8,000,000 of the profit be treated as having been distributed as dividend.

Required:

Compute the amounts deemed as income in the hands of the shareholders.

- 5. In 2024 Bada Ltd received a gross dividend of ~~N~~5,000,000 from Bawa Ltd. for the accounting year ended December 31, 2024, Bada Ltd made a net profit before tax of ~~N~~25,000,000 including the gross dividend from Bawa Ltd. The dividend was received less 10% withholding tax deducted at source.

Required:

Compute the income tax liability of Bada Ltd. on the assumption that:

- (a) the company did not pay any dividend to its shareholders during the year;
- (b) the company pays a gross dividend of ~~N~~5,000,000 to its shareholders during the year; and
- (c) the company pays a gross dividend of ~~N~~15,000,000 to its shareholders during the year.

The company pay a gross dividend of ~~N~~2,750,000 to its shareholders during the year.

9.8.2 Suggested solutions to questions

- 1. Interest on loans granted by banks for primary agricultural production shall be exempted from tax, if 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.

In addition to the above, small and medium-sized companies engaged in primary agricultural production shall be granted:

- a) pioneer status for an initial period of four (4) years and an additional period of two (2) years, subject to satisfactory performance; and
- b) a reduction in import duty on tractors from 35% to 5%.

To enjoy these incentives, these companies are expected to apply to the President through the Minister for Industry, Trade and Investment.

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.

2(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 for example, 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.

3.

Mr. Emeka

Computation of rental income
For the relevant assessable years

	2022		2023	
	₦	₦	₦	₦
Rent received		7,000,000		7,000,000
Less: Allowable expenses:				
Repairs and maintenance:				
Repairs of tenant's bathroom	-		360,000	
Water rate	164,000		210,000	
Agent's commission	700,000		700,000	
Professional charges	200,000		300,000	
Insurance	104,000		104,000	
Caretaker's wages	36,000		44,000	
Tenement rate	<u>40,000</u>	<u>(1,244,000)</u>	<u>24,000</u>	<u>(1,742,000)</u>
Assessable rent		5,756,000		5,258,000
Less: Capital allowances		<u>(960,000)</u>		<u>(240,000)</u>
Chargeable rent		<u>4,796,000</u>		<u>5,018,000</u>

4.

Chike & Sons Limited
Computation of amount deemed as income
In the hand of shareholders

	Deemed	Dividend
		₦
Williams Nelson	<u>4,000,000</u>	
	10,000,000 X $\frac{4,000,000}{10,000,000}$	3,200,000
Samuel Nelson	<u>2,000,000</u>	
	10,000,000 X $\frac{2,000,000}{10,000,000}$	1,600,000
Tamara Nelson	<u>1,000,000</u>	
	10,000,000 X $\frac{1,000,000}{10,000,000}$	800,000
Malia Nelson	<u>3,000,000</u>	
	10,000,000 X $\frac{3,000,000}{10,000,000}$	2,400,000

5.

Bada Ltd.
Computation of income tax liability
For 2025 assessment year

(a) Bada Ltd paid on dividend to its shareholders

	N'000
Net profit before tax	
(including gross dividend received)	25,000
Less gross dividend received	<u>5,000</u>
Taxable profit	<u>20,000</u>
Income tax payable on profit (30% x N20,000,000)	<u>6,000</u>

Notes

Since the dividend received by Bada Ltd has not been redistributed, it cannot set off the withholding tax suffered against its tax liability. In other words, Bada Ltd has not been able to recoup the withholding tax of N500,000 due to non-distribution of dividend received.

(b) Bada Ltd redistributed the whole dividend received

		N'000
Net profit before tax (including gross dividend received)		25,000
Less gross dividend received		<u>5,000</u>
Taxable profit		<u>20,000</u>
Income tax payable on profit (30% x N20,000)		6,000
Add withholding tax on dividend paid		
(10% x N5,000)	500	
Less WHT on dividend received		
(10% x N5,000)	<u>500</u>	<u>0</u>
Total tax payable		<u>6,000</u>

Notes

The withholding tax suffered on the dividend received by Bada Ltd has been used to offset the withholding tax due on the dividend redistributed by the company. Thus, Bada Ltd does not need to pay withholding tax in cash to the tax authority on the dividend redistributed.

(c) Bada Ltd paid a dividend of ₦15,000,000 to its shareholders

		₦'000
Net profit before tax		~~₦~~ 000
(including gross dividend received)		25,000
Less gross dividend received		<u>5,000</u>
Taxable profit		<u>20,000</u>
Income tax payable on profit		
(30% x 20,000)	6,000	
Add WHT on dividend paid		
(10% x 15,000)	1,500	
Less WHT on dividend received		
(10% x 5,000)	<u>(500)</u>	<u>1,000</u>
Total tax payable	<u>7,000</u>	

Notes

The withholding tax suffered of ₦500,000 suffered by Bada Ltd on dividend received has been set off against the withholding tax of ₦1,500,000 due on the dividend paid by the company. Bada Ltd will be required to pay only the balance of withholding tax, which is, ₦1,000,000 to the tax authority.

(d) Bada Ltd redistributed part of the dividend received

		₦'000
Net profit before tax		
(including gross dividend received)		25,000
Less gross dividend received		<u>5,000</u>
Taxable profit		<u>20,000</u>
Income tax payable on profit		
(30% x ₦20,000)		6,000
Add WHT on dividend paid		
(10% x ₦2,750)	275	
Less WHT on dividend received		
(10% x ₦5,000)	<u>500</u>	
Balance of WHT on dividend received	<u>(225)</u>	<u>0</u>
Total tax payable		<u>6,000</u>

Notes

Bada Ltd has been able to recover only ₦275,000 out of the ₦500,000 withholding tax suffered because the withholding tax suffered on dividend received is more than the withholding tax deducted from dividend paid. Based on the provisions of CITA 2007, it is possible for the company to claim a refund of the balance of withholding tax on dividend received (₦225,000) or carry forward and set off against future withholding tax on dividend paid by the company.

TAX INCENTIVES

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10 Tax Incentives

10.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the basic concepts and application of taxation incentives.

10.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

- (a) understand the relevant arms of government involved in formulation, approval and issuance of pioneer status incentives certificate;
- (b) ascertain pioneer status incentives regulations by Nigerian Investment Promotion Commission (NIPC) in 2014 and Federal Ministry of Industry, Trade and Investment 2017;
- (c) know the various pioneer industries and products on the pioneer list;
- (d) understand the procedure for applying and obtaining pioneer status and how pioneer certificate can be amended and the circumstances for its cancellation;
- (e) know the provisions relating to retrospective operations and the date of production certification;
- (f) ascertain the conditions relating to qualifying capital expenditure for pioneer industries.
- (g) determine the tax relief period and the conditions for extension of pioneer period;
- (h) know the tax incentives available to pioneer industries;
- (i) understand tax incentives for gas utilisation as specified by the CITA, Fiscal Incentives for Downstream Gas Utilisation, 2024 and relevant Finance Acts;
- (j) ascertain the digital economy incentives, startups (Nigerian Start-up Act 2022);
- (k) understand tax incentives for small businesses, manufacturing, agricultural and exports business; and
- (l) determine the tax implications of operations in the free trade zones.

10.2 Relevant definitions

The terms defined in section 25 of IDA and their respective meanings are reproduced below:

- (a) accounting period: A period for which accounts have been made up in accordance with the requirement of paragraph (c) of section 11 of IDA.
- (b) Revenue Service: The Federal Inland Revenue Service established under CITA.
- (c) company: A company (other than a private company) limited by shares and incorporated and registered in Nigeria and resident in Nigeria.
- (d) the Council: The National Council of Ministers (Federal Executive Council).
- (e) the Director: The director appointed pursuant to Section 1(3) of the Industrial Inspectorate Act.

- (f) Gazette: The Federal Gazette and includes the Gazette of any state in the Federation.
- (g) the Minister: The Minister for industry.
- (h) 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.
- (i) 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.
- (j) 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.
- (k) pioneer certificate: A certificate given under IDA certifying, among other things, a company to be a pioneer company.
- (l) pioneer company: A company certified by any pioneer certificate to be a pioneer company.
- (m) pioneer enterprise: In relation to a pioneer company, means the production and sale of its relevant pioneer product or products.
- (n) pioneer industry: Any trade or business of the kind included in any list of pioneer industries published in the gazette.
- (o) pioneer product: Goods or service of the kind included in any list of pioneer products published in the gazette.
- (p) Principal Act: The Companies Income Tax Act.
- (q) production day: The day on which the trade or business of a pioneer company commences for the purpose of CITA.
- (r) qualifying capital expenditure: Capital expenditure of such a nature as to rank as Qualifying expenditure for capital allowances purposes of the principal Act.
- (s) product: The pioneer product or products and the permissible by-pioneer product or products specified in the pioneer certificate of any company.
- (t) tax relief period: The period specified under subsection (1) of Section 10 of IDA and any extension of that period made under that Section.

10.3 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.
- e) **Federal Inland Revenue Service ("FIRS"):** The FIRS is responsible for implementing PSI and issuing certificates of qualifying capital expenditure.

10.4 Pioneer status incentives regulations by Nigerian Investment Promotion Council (NIPC) in 2014 and Federal Ministry of Industry, Trade and Investment 2017

- a) Where the National Council of Ministers (the Council) is satisfied that a product is qualified as a pioneer and the applicant meets the below stated conditions:
 - i. 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
 - ii. 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:

- 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;

- an applicant must be engaged in an activity listed as a pioneer industry or pioneer product; and
 - an applicant must provide evidence of all required legal and regulatory compliance documentation.
- b) 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:
- i. state whether the company is, or the proposed company when incorporated, shall be an indigenous-controlled company;
 - ii. 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;
 - iii. specify the place in which the assets are to be situated;
 - iv. state the probable production day;
 - v. 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;
 - vi. 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;
 - vii. 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
 - viii. in the case of a proposed company, give the name, address and nationality of each promoter of the company.

10.5 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).

S/N	Industries	Products
3.	a. Deep sea trawling and processing b. Coastal fishing and shrimping	Preserved sea foods, fish and shrimps, fish meal
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 glass-ware
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, 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. Fertilisers; 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 metal	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

S/N	Industries	Products
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 kernel 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, ballasts/ starters/ lighters, discrete 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 equipment and other materials	Cameras, photographic equipment or any component 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 playback/recorders, loudspeaker units, amplifying systems, microphones, video playbacks/ recorders, PBX, telephone handset, tele-printers, trans-receivers, auto-phones/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

S/N	Industries	Products
45.	Bitumen mining and processing	Bitumen
46.	Salt production	Salt
47.	Manufacture of firefighting equipment and detection systems	Firefighting 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; 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.

10.5.1 List of new Industries added to Pioneer list

- (a) Mining and processing of coal;
- (b) Processing and preservation of meat/poultry and production of meat/poultry products;
- (c) Manufacture of starches and starch products;
- (d) Processing of cocoa;
- (e) Manufacture of animal feeds;
- (f) Tanning and dressing of leather;
- (g) Manufacture of leather footwear, luggage and handbags;
- (h) Manufacture of household and personal hygiene paper products;
- (i) Manufacture of paints, vanishes and printing ink;
- (j) Manufacture of plastic products (builders' plastic ware) and moulds;
- (k) Manufacture of batteries and accumulators;
- (l) Manufacture of steam generators;
- (m) Manufacture of railway locomotives, wagons and rolling stock;
- (n) Manufacture of metal-forming machinery and machine tools;
- (o) Manufacture of machinery for metallurgy;
- (p) Manufacture of machinery for food and beverage processing;
- (q) Manufacture of machinery for textile, apparel and leather production;
- (r) Manufacture of machinery for paper and paperboard production;
- (s) Manufacture of plastics and rubber machinery;
- (t) Waste treatment, disposal and material recovery;
- (u) E-commerce services;
- (v) Software development and publishing;
- (w) Motion picture, video and television programme production, distribution, exhibition and photography;
- (x) Music production, publishing and distribution;
- (y) Real estate investment vehicles under the Investments and Securities Act;
- (z) Mortgage-backed securities under the Investments and Securities Act; and
- (aa) Business process outsourcing.

10.6 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:

10.6.1 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. 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; and
 - 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.
- 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 of ₦200,000: 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 ₦500,000: 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 ₦2,500,000: 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 Industrial Inspectorate Department (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; and
 - 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. Decision making

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:

- i) complete part 11 of application form; and
- ii) 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:

- i) reviews application for completeness;
- ii) requests inspection visit;
- iii) visits project; and
- iv) 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.

10.6.2 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 ₦100,000; 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.

10.6.3 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.

10.6.4 Procedure for the amendment of pioneer certificate

The procedure is as follows:

- a) the application for the amendment of pioneer certificate must be in writing;
- b) it must state the reasons for such application;
- c) it must state any additional products or by-products as the case may be; and
- d) where the application is approved, the original pioneer certificate may be amended to have retrospective effect.

10.7 Retrospective operations and the date of production certification

a) 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.

b. 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.

c. 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.

d. Importance of the production day certificate are as follows:

- i) it is the day when the tax-free period starts to run;
- ii) the qualifying capital expenditure of the company must not fall below the statutory minimum on that day; and

- iii) 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.

e. Material date

Material date means:

- i) 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
- ii) 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.

10.8 Conditions relating to qualifying capital expenditure for pioneer industries

- (a) The qualifying capital expenditure of the company must not fall below the statutory minimum estimated cost on or before production day of ₦10,000,000.
- (b) 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 should be duly disclosed.
- (c) The place the qualify capital expenditure to be situated are duly stated.
- (d) A certificate of qualifying capital expenditure should be duly issued to the company by the FIRS applying for PSI.
- (e) A certificate of qualifying capital expenditure should be duly issued to the company by the FIRS prior to applying for PSI extension within a month before the expiration of the initial PSI period.
- (f) 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.
- (g) Where the values of the qualifying capital expenditure as on the production day is less than the prescribed minimum value applicable to the company, the certificate of pioneer can be cancelled.
- (h) The qualifying capital expenditure incurred prior to or 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.

10.9 Circumstances for the 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.
- 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 fulfil any estimate or proposal made in its application for a pioneer certificate or any of the conditions contained in its pioneer certificate.
- 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 1/7/2023, and date of cancellation is 30/4/2024 the effective date of cancellation in this case shall be 1/7/2023.

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 1/1/2023 and date of cancellation is 30/3/2025. In this case, the effective date of cancellation shall be 1/1/2025.

10.10 Tax relief period and conditions for extension

10.10.1 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:

- a) two periods of one year each; or
- b) 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.

10.10.2 Conditions for extension of pioneer period

- 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.
- g) The fulfilment of any other condition as may be laid down by the Minister of Finance.

10.11 Tax incentives available to pioneer industries

a) The various tax incentives available to pioneer industries are as follows:

- i. The profit of a pioneer company during the pioneer period is exempted from tax;
- ii. 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;
- iii. 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;
- iv. 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
- v. dividend paid out of pioneer profit shall not be chargeable to tax in the hands of the recipient.

b) Purpose of tax incentives in Nigeria are:

- 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 zones (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.

c) Basis of granting tax incentives either on industry basis or by tax type

- (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.

d) Benefits and criticisms of tax incentives

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:

- (i) 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;
- (ii) it is a convenient tool to attract industries that will help to solve unemployment problem;
- (iii) 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;
- (iv) 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.;
- (v) tax incentives help in drawing attention to the profit prospects of investing in certain types of business that a country seeks to promote;
- (vi) it is also necessary to compete in the international capital market; and
- (vii) 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.

e) Criticisms of tax incentives

- (i) 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;
- (ii) 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;
- (iii) 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;
- (iv) 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 great extent diluted its promotional value;
- (v) The grant of tax incentives has been criticised because it is said to be disproportionate as the benefit derived varies from firm to firm and as such, firms that are more profitable will likely enjoy more benefits than those with little or no profit; and
- (vi) 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.

10.12 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.

- 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.

10.13 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 Section 10 (6)).

In determining whether such a loss has been made, the Revenue Service may in its absolute discretion exclude such sum as may be more than 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

- i. No capital allowance shall be claimed during the pioneer period.
- ii. 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.

10.14 Restrictions applicable to pioneer industries

(a) Non-pioneer product during pioneer period

If during the pioneer period, a pioneer company also deals in products other than 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.

10.15 Tax incentives for gas utilisation as specified by the CITA, fiscal incentives for downstream gas utilisation, 2024 and relevant Finance Acts

A company engaged in gas utilisation (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; and
 - 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.

10.15.1 Relevant Finance Acts on incentives for gas utilisation

Provision of Finance Act, 2020 on incentives for gas utilisation

The Finance Act, 2020 amended section 39(1) to grant the incentives only to companies whose trade or business involves gas utilisation in downstream operations. The mere consumption of gas does not qualify for the claim of this incentive, while 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 utilisation 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.

Provision of Order 2024 on incentives for gas utilisation

The provisions of oil and gas companies (Tax Incentives, Exemption, Remission, etc.) Order, 2024 are stated below:

- (i) As from the commencement of this Order, the tax credit incentives specified under subparagraphs (2) and (3) of this Paragraph shall apply to non-associated gas (NAG) greenfield developments in onshore and shallow water locations, with first gas production on or before January 1, 2029;
- (ii) where the hydrocarbon liquids (HCL) content:
 - does not exceed 30 barrels per million Standard Cubic Feet (SCF), there shall be a gas tax credit at the rate of US\$1.00 per thousand cubic feet or 30% of the fiscal gas price, whichever is lower; and
 - exceeds 30 barrels per million SCF but does not exceed 100 barrels per million SCF, there shall be a gas tax credit at the rate of US\$0.50 per thousand cubic feet or 30% of the fiscal gas price, whichever is lower;
- (iii) any other greenfield NAG project with first commercial production after January 1, 2029, shall be eligible for gas tax allowance at a rate of US\$0.50 per thousand SCF or 30% of the fiscal gas price, whichever is lower, provided that the hydrocarbon liquids content does not exceed 100 barrels per million SCF;
- (iv) the hydrocarbon liquids (HCL) content in a non-associated gas field shall be as determined in a guideline issued by the Nigerian Upstream Petroleum Regulatory Commission;
- (v) the gas tax credit shall apply for a maximum of 10 years, after which it shall become a gas tax allowance claimable at the respective rates set out in subparagraph (2) (a) and (b) of this Paragraph;
- (vi) the gas tax credit accruable under this Paragraph in any year for a company shall not:
 - exceed the companies' income tax payable for that year by that company; and
 - be combined with the Associated Gas Framework Agreement (AGFA) incentives for the same greenfield NAG project;

- (vii) where there is a gas tax credit surplus in any year, the surplus shall be carried forward to the subsequent year, provided that tax credit surplus shall only be carried forward for a maximum of three years;
- (viii) the fiscal gas price for calculating a gas tax credit under this Order shall be the same price used for determining royalties under the Petroleum Industry Act (PIA).

10.16 Digital economy incentives, startups (Nigerian Start-up Act 2022)

10.16.1 Nigerian Start-up Act 2022

The Nigeria Startup Act, 2022 (the NSA 2022) was passed into law on October 19, 2022. The Act aims to create an enabling environment for investing, attracting, and protecting investment and innovation in tech- startups. According to the NSA 2022, "Startup" means a company in existence for not more than ten years, with its objectives being the creation, innovation, production, development or adoption of a unique digital technology innovative product, service or process as stated below:

- a) The Nigerian Startup Act of 2022 provides digital economy incentives, structures and programmes for Nigerian startups to catalyse growth, create value. It establishes a framework for the development of startups, including the National Council for Digital Innovation and Entrepreneurship. The Act aims to create an enabling environment for technology-enabled startups, offering tax incentives, access to funding, and other support programs.
- b) The Nigeria Export Processing Zone Authority (NEPZA) is tasked with setting up technology development zones and licensing startups, accelerators, and incubators to operate within them.
- c) The Act offers tax credits for investments in labelled startups, exemptions from capital gains tax for certain investments, and allows for repatriation of investment proceeds in freely convertible currency. Gains from the disposal of labelled startup assets held for at least 24 months by eligible investors are exempt from capital gains tax.
- d) The NSA established 'The National Council for Digital Innovation and Entrepreneurship' ("the Council"). The Council will consist of the Nigerian President and Vice-President as Chairman and Vice-Chairman, respectively. Other members of the Council include the Ministers responsible for Communications and Digital Economy, Finance, Budget and National Planning, Industry, Trade and Investments, Science, Technology, and Innovation.
- e) The Council membership also includes The Governor of the Central Bank of Nigeria (CBN), four representatives of the Startup Consultative Forum, one representative each from the Nigerian Computer Society, and the Computer Professionals (Registration Council of Nigeria).

- f) The Director-General of the National Information Technology Development Agency (NITDA) serves as the secretary of the Council.
- g) The Secretariat of the Council is responsible for managing the of labelling a startup, establishing public online and other platforms for providing access to information on the establishment and development of a startup, incubation, acceleration and venture- building programmes. Furthermore, the Secretariat will collaborate with the relevant Ministries, Departments, Agencies (MDAs) and other stakeholders to promote innovation in digital technology and enterprise development for a startup in Nigeria.
- h) The Council is responsible for, among others, formulating and providing general policy guidelines to achieve the objective of the Act and supporting digital technological development through grants to persons, research institutions, and universities pursuing postgraduate programmes in science, technology and innovation. The Council also has the power to review policies and directives of MDAs, which may affect the establishment, operations, and investments in a startup.

10.16.2 Startup labelling process

- a) A startup label under this Act is a certificate issued by the Secretariat to a startup upon the fulfilment of the labelling requirements under this Act.
- b) A startup is eligible for labelling under this Act, where:
 - i) it is registered as a limited liability company under the Companies and Allied Matters Act, and has been in existence for a period not more than 10 years from the date of incorporation;
 - ii) its objects are innovation, development, production, improvement, and commercialisation of a digital technology innovative product or process;
 - iii) it is a holder or repository of a product or process of digital technology, or the owner or author of a registered software;
 - iv) it has at least one-third local shareholding held by one or more Nigerians as founder or co-founder of the startup; and
 - v) in the case of a sole proprietorship or partnership, it satisfies the conditions set out in paragraphs (ii), (iii) and (iv).
- c) This Act shall not apply to an organisation which is a holding company or subsidiary of an existing company which is not registered as a startup.
- d) A sole proprietorship or partnership referred to in subsection (2)(e) shall be granted a pre-label status for a period of six months to enable the sole proprietorship or partnership comply with the requirements set out in subsection (2) (a), (b), (c) and (d).
- e) A sole proprietorship or partnership which fails to comply with the provisions of subsection (4) shall lose the pre-label status granted to it.

- f) A labelled startup shall be granted access to the incentives provided under this Act.
- g) A startup desirous of being granted a label under the provisions of this Act shall submit an application on the Startup Portal in the prescribed form.
- h) An application shall be supported by documents prescribed by the Secretariat:
 - i) where the Coordinator is satisfied that an applicant has complied with the requirements for labelling under this Act, the Coordinator shall:
 - * with the approval of the Secretariat enters the name and particulars of the applicant in the register of startups kept for that purpose; and
 - * issue to the startup, a startup label;
 - ii) the certificate issued shall, unless the contrary is proven, be conclusive evidence that the startup has;
 - iii) complied with all the requirements for labelling specified under this Act; and
 - iv) been duly labelled, in accordance with this Act.
- i) A startup label shall be valid for a period of 10 years from the date of issuance.

10.16.3 A labelled startup under this Act

It shall:

- a) comply with all the extant laws governing businesses in Nigeria;
- b) provide information annually on the number of human resources, total assets and the annual turnover achieved from the period the startup label was granted;
- c) maintain proper book of accounts in accordance with reporting obligations provided under extant laws and regulations;
- d) provide an annual report on incentives received and advancements made by virtue of the incentives;
- e) notify the Coordinator of any change in structure, composition or objects within a period of one month from the date of such change;
- f) comply with the obligations set out by the Coordinator after issuance of the startup label.
- g) where a labelled startup defaults in any of the obligations, or fails to meet the eligibility criteria under this Act, the Coordinator shall notify the labelled startup of the default, and within 30 days of the notification, the startup shall take steps to rectify the default;
- h) where a labelled startup fails to regularise the default after being notified, the Secretariat shall withdraw the startup label and notify the relevant MDAs or investors that may have granted incentives to such labelled startup; and
- i) where a startup, whose startup label is withdrawn in accordance with the provision of the Act, rectifies the default, it may apply to the Secretariat for a re-issuance of the startup label.

10.16.4 Incentives for labelled startups

The Startup Act includes a range of tax and financial incentives for labelled startups, venture capitalists, angel investors, private equity companies, accelerators, and incubators.

- a) **Access to funding:** The Act mandates an annual allocation of at least ₦10 billion to the Startup Investment Seed Fund ("the Fund"), with the National Council for Digital Innovation and Entrepreneurship determining funding sources, management, and access to the fund, as well as establishing an innovation grant framework to support research and development initiatives.
- b) In addition, the Act tasks NITDA with creating a Credit Guarantee Scheme to offer financial and credit assistance to labelled startups. These financial incentives are pivotal for startups, particularly during the initial growth phase. By providing this financial stimulus, the government aims to facilitate the expansion of startups, foster the creation of innovative products and services, and generate employment opportunities for the growing youth population in Nigeria.
- c) **Tax incentives:** Labelled startups are eligible for tax breaks and incentives aimed at easing financial challenges of establishing and scaling a business. These include:
 - i) **pioneer status incentive (PSI):** Labelled startups operating in eligible industries can apply through accelerated protocols via the Secretariat to the Nigerian Investment Promotion Commission (NIPC) for PSI. If granted, the labelled startup would be entitled to a tax holiday for an initial period of three (3) years, which may be extended for an additional two (2) years;
 - ii) **exemption from Contribution to Industrial Training Fund (ITF):** The Act exempts labelled startups from contributions of 1% of annual payroll cost, to ITF where it provides in-house training to its employees for the duration of the startup label.
 - research and development tax deductions: Research and development costs wholly incurred in Nigeria will be tax deductible; and
 - a labelled startup will be permitted to deduct only a 5% Withholding Tax (WHT) from the income earned by a non-resident company providing technical, consulting, professional, or management services, which is currently applicable at 10%.
- d) **Access to export facilities:** Labelled startups involved in the exportation of products and services deemed eligible under the Export (Incentives and Miscellaneous Provisions) Act, are entitled to export incentives and financial assistance from the Export Development Fund, Export Expansion Grant and the Export Adjustment Scheme Fund.

- e) **Establishment of technology development zones:** The Act provides for collaboration between the Secretariat and the Nigeria Export Processing Zones Authority (NEPZA) to establish a Technology Development Zone ("the Zone") to spur the growth and development of startups, accelerators, and incubators. Startups, accelerators, or incubators situated in the zone will be entitled to existing incentives provided under the NEPZA Act including tax exemption, non-applicability of the FX regime administered by the CBN, exemption from import duties, etc.
- f) Other benefits of the Secretariat and startup portal include:
 - i) the Secretariat will collaborate with the CAC to designate a separate section on the startup portal to facilitate seamless, expedited processes and transactions carried out by the labelled startups with the CAC;
 - ii) the Secretariat will collaborate with the Nigerian Copyright Commission and the Trademarks, Patent and Design Registries to ensure that the registration and protection of intellectual property of labelled startup is seamless and expedited;
 - iii) labelled startups can raise funds through crowdfunding intermediaries and commodities investment platforms licensed by the SEC, through an expedited process;
 - iv) the Secretariat in conjunction with NOTAP will designate a section on the startup portal to ease technology transfer registration for labelled startups. In addition, labelled startups will enjoy discounts on all applicable fees for technology transfer registrations;
 - v) the Secretariat in conjunction with the CBN and SEC will ensure that labelled startups operating as financial technology ("Fintech") companies will have access to simplified licensing procedures with the CBN and SEC through a designated section on the startup portal;
 - vi) the Secretariat will facilitate the process of a labelled startup that seeks to list on the Nigerian Exchange (NGX) and may grant incentives to promote growth and development; and
 - vii) the guarantee of repatriation of investment by foreign investors through CBN's authorized dealers in a freely convertible currency subject to a Certificate of Capital Importation (CCI).

10.17 Tax incentives for small businesses, manufacturing, agricultural and exports business

10.17.1 Tax incentives for small businesses

There was no major difference between small, medium, and large companies for tax purposes in Nigeria, before the introduction of the Finance Act (FA), 2019. All companies were subjected to income tax at the rate of 30% in line with the provisions of the Companies Income Tax (CIT) Act, with the exception of companies engaged in agriculture, mining, and manufacturing with a turnover of less than one million naira. The

Finance Acts, introduced an amendment to the CIT Act, classifying companies into small, medium, and large based on their turnover and introduced different income tax rates applicable to each company type.

The CIT Act (as amended by the Finance Act 2019) defines a small company as a company with a turnover of less than twenty-five million naira in a year, a medium company; turnover between 25 million and 100 million naira and a large company, turnover above 100 million naira.

The FGN through the Finance Acts introduced some tax incentives to support the growth of SMEs by reducing their tax compliance and payment burden. Some of the tax incentives are enumerated below:

- a) **Exemption from payment of Companies Income Tax & Tertiary Education Tax (TET):** Section 55 of the CIT Act (as amended) requires every company (including a company granted exemption from incorporation) to submit its income tax returns, whether the company is liable to pay tax. However, by virtue of amendments introduced by the Finance Acts 2019 and 2020 to section 23 of the CIT Act and section 1 of the Tertiary Education Trust Fund Act, the profits of a small company have been exempted from CIT and TET. This implies that although small companies would submit their tax income tax returns as and when due (that is, six months after the end of its accounting year), they would not be liable to any CIT and TET.
- b) **Exemption from payment of tax on dividends from small manufacturing companies:** The dividends received by a small company from another small company in the manufacturing sector in the paying company's first five years of operation is exempt from tax, as per Section 23(1)(o)(ii) of the CIT Act.
- c) **Exemption from payment of minimum tax:** Minimum tax is payable in an assessment year where a company has no taxable profit or when the income tax calculated is lower than the minimum tax (calculated as 0.5% of a company's gross turnover). Small companies are exempted from the payment of minimum tax, based on the provisions of Section 33 of the CIT Act, as amended by the Finance Act 2019.
- d) **Exemption from compliance with the provisions of the Value Added Tax Act:** Small companies are exempted from registering for VAT, issuing tax invoices, remitting and rendering a monthly return and from the penalties prescribed by the Act for non-compliance with the administrative provisions. This incentive is very germane, as it relieves small companies of the administrative burden associated with rendering monthly VAT returns.

10.17.2 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:

a) 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.

b) 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 relate to businesses to which allowances are granted. The result of such research could be patented and protected in accordance with internationally accepted industrial property rights.

c) 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%.

d) 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.

e) 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.

f) In-plant training

2% tax concession for five years, of the cost of the facilities for training.

g) Export oriented industries

10% tax concession for five years. This concession will apply to industries that export not less than 6% of their products.

h) 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.

i) Investment in economically disadvantaged areas

100% tax holiday for seven years and additional 5% depreciation over and above the initial capital depreciation.

j) 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 January 1, 1999 but was immediately reintroduced the following year. Goods liable to excise duty are:

- i) Beer and stout;
- ii) wines;
- iii) spirits; and
- iv) cigarettes and tobacco that are manufactured and sold in Nigeria.

k) 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.

l) 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.

m) 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:

- i) dividends or profit (net of taxes) attributable to the investment;
- ii) payments in respect of loan servicing where a foreign loan has been obtained;
- iii) remittance of proceeds (net of all taxes) and other obligations in the event of

- a sale or liquidation of the enterprise; or
- iv) any interest attributable to the investment.

n) 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:

- i) payments of fair and adequate compensation; and
- ii) right of access to the courts for the determination of the investor's interest right and the amount of compensation to which he is entitled.

The Nigerian government is prepared to enter into investment protection agreement with foreign enterprises wishing to invest in Nigeria.

(p) 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.

10.18 Other sectors' incentives

(a) Public infrastructure and employment Relief

[Companies Income Tax (Exception of Profit) Order, 2012] The commencement date was April 27, 2012 and lasted for 5 years subject to the specific conditions under each incentive.

- (i) **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.
- (ii) **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.
- (iii) **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.

(b) 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.

c) 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.

d) Petroleum industry

Very similar generous incentives package was granted the joint venture system and is contained in the MOU signed with oil companies.

e) 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;

- (i) companies in the agro-allied business do not have their capital allowances restricted to 60% but graduated in full - 100%; and
- (ii) agro-allied plant and equipment enjoy enhanced capital allowances of up to 50%.

f) 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:

- (i) 3 to 5 years tax holiday;
- (ii) deferred royalty payments depending on the magnitude of the investment and strategic nature of the project;
- (iii) possible capitalisation of expenditure on exploration and surveys;
- (iv) provision of 100% foreign ownership of mining companies or concerns; and
- (v) 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.

g) 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.

h) Energy sector

All areas of investment in this sector are 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.

i) 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, 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.

j) 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.

k) Export incentives for non-oil sector

- (i) **Export proceeds:** Export proceeds can be retained in foreign currency in a domiciliary account with any authorised bank in Nigeria.
- (ii) **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.
- (iii) **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.

10.19 Tax implications of operations in the free trade zones

10.19.1 Tax incentives and fiscal measures in favour 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' Tax holiday.
- f) Investment capital allowance.
- g) All dividends distributed during the tax holiday shall be tax-free.

10.19.2 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).

10.20 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. The benefits and demerits of tax incentives were also discussed.

Readers must have learnt how the Finance Acts 2020, 2021, 2022, 2023 and 2024 impact on some of the incentives available to companies in Nigeria.

10.21 Worked examples

10.21.1 Questions

1. New Era Processing Co. Ltd. was established in 2019 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, 2020	1,200,000	Loss
Year ended	September 30, 2021	3,000,000	Profit
Year ended	September 30, 2022	5,500,000	Profit

Capital allowances for the relevant years of assessment were computed and agreed with the Federal Inland Revenue Service as follows:

	₦
2020 Year of assessment	1,500,000
2021 Year of assessment	1,200,000
2022 Year of assessment	1,400,000
2023 Year of assessment	1,100,000

Required:

Determine the tax liabilities of the company for all the relevant years. Please note that the company was denied pioneer status.

2. Princess Nigeria Limited was incorporated on January 1, 2018. It was granted a pioneer certificate on April 1, 2018, as the production day. Its audited financial statements revealed the following:

Accumulated losses as at March 31, 2021 - ₦500,000

Tax Year	Capital Allowance
	₦
2023	2,300,000
2024	200,000
2025	500,000

The net profit for the year ended March 31, 2022, 2023 and 2024 were ₦250,000, ₦500,000 and ₦750,000 respectively after charging depreciation of ₦1,750,000, ₦2,000,000 and ₦750,000 for the respective years. Extension of initial pioneer period was never sought for.

Required:

Compute the tax liabilities of the company for the relevant years of assessment.

3. The Industrial Development (Income Tax Relief) Act (IDITRA), originally enacted in 1971 and subsequently amended, serves as a cornerstone of Nigeria's fiscal policy aimed at stimulating industrial growth and economic diversification. The Act provides for the granting of Pioneer Status Incentives (PSI) to companies operating in sectors deemed vital to national development. Through the issuance of pioneer certificates, eligible companies are granted income tax relief for an initial period of three years, extendable by two additional years, thereby fostering reinvestment and expansion during their formative stages

Required:

Discuss the following, with respect to Industrial Development (Income Tax Relief) Act, Treatment of Losses and capital allowances of pioneer period:

- a. Restriction on trading prior to end of tax relief period
 - b. Restriction on distribution of dividend and granting of loans
 - c. Provision for plantation industry
 - d. Accounting periods
4. 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:

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.
5. Mr. Dokpesi who studied in Canada and had been working there for over 25 years finally returned to Nigeria in 2020.

He made some savings to start a new business and incorporated Dokpesi Investments Limited in January 2021. 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. Dokpesi 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. Dokpesi and he is eager to have more information to avoid pitfalls.

Required:

Given his reservation about the current business climate in Nigeria:

- a) Explain **Six** (6) reliefs and incentives available to corporate taxpayers.
 - b) Outline **Three** (3) conditions a company must fulfil to qualify for tax incentives for export-oriented business.
6. Lazarus Nigeria Limited, a company granted pioneer certificate on July 1, 2018, had the following results:

			₦
Year ended	30/06/19	Profit	6,000,000
Year ended	30/06/20	Profit	5,000,000
Year ended	30/06/21	Loss	13,000,000
Period to	31/12/21	Profit	15,000,000
Year ended	31/12/22	Profit	16,000,000
Year ended	31/12/23	Profit	16,800,000

Accumulated capital allowances during pioneer period amounted to ₦12,720,000, while capital allowances are ₦2,800,000 per annum

Required:

Compute the tax liabilities for all the relevant years of assessment.

10.20.2 Suggested solutions to questions

1. New Era Processing Co. Ltd. Income tax computation

Date of commencement of business –July 1, 2018, Commencement provisions:

Assessment Year	Basis period		
2020	1/07/2019 to 30/9/2019		
2021	1/10/2019 to 30/9/2020		
2022	1/10/2020 to 30/9/2021		
2023	1/10/2021 to 30/9/2022		
2024	1/10/2022 to 30/9/2023		
		N	N
2020			
Loss 3/15 x 1,200,000			<u>(240,000)</u>
Therefore, 2020 Assessment Capital allowance unutilised c/f		<u>1,500,000</u>	NIL
2021			
Loss 12/15 x 1,200,000			<u>(960,000)</u>
Therefore, 2021 Assessment			NIL
Capital allowances:			
For year		1,200,000	
Brought forward		<u>1,500,000</u>	
Carried forward		<u>2,700,000</u>	
2022 Profit			3,000,000
Capital allowances			
For year		1,400,000	
Brought forward		<u>2,700,000</u>	
		3,100,000	
Relieved		<u>3,000,000</u>	<u>3,000,000</u>
Carried forward		100,000	
Therefore, 2022 Assessment			NIL
2023 Profit			5,500,000
Capital allowances			
For year		1,100,000	

Brought forward	<u>100,000</u>	
	1,200,000	
Amount that can be relieved	<u>1,200,000</u>	(1,200,000)
Taxable profit		<u>4,300,000</u>
Tax liability @ 30%		<u>1,290,000</u>

Notes:

Cocoa processing will fall into the business of manufacturing, hence no restriction of capital allowances.

2.

Princess Nigeria Limited

Computation of tax liabilities

For all the relevant assessment years

	<u>₦</u>	<u>₦</u>
2023 assessment year		
Assessable profit (01/04/21 – 31/03/22)		
(~~₦~~ 250,000 + ~~₦~~ 1,750,000)		2,000,000
Less Balance on Section 17 Account		<u>500,000</u>
		1,500,000
Less capital allowance	2,300,000	
Relieved	<u>1,500,000</u>	<u>1,500,000</u>
Capital allowance carried forward	<u>800,000</u>	
Total profit		<u>Nil</u>
Tertiary education tax (3% of ~~₦~~ 2,000,000)		<u>60,000</u>
2024 assessment year		
Assessable profit (01/04/22 – 31/03/23)		
(~~₦~~ 500,000 + ~~₦~~ 2,000,000)	2,500,000	
Less capital allowance brought forward	800,000	
Capital allowance for the year	<u>200,000</u>	
Relieved	<u>1,000,000</u>	<u>1,000,000</u>
Taxable Profit		<u>1,500,000</u>
Tax payable @ 30%		<u>450,000</u>
Education Tax (3% of ~~₦~~ 2,500,000)		<u>75,000</u>

2025 assessment year

Assessable Profit (01/04/23 – 31/03/24) (750,000 + 750,000)	1,500,000
Less capital allowance	<u>500,000</u>
Taxable Profit	<u>1,000,000</u>
Tax payable @ 30%	<u>300,000</u>
Education Tax (3% of ₦1,500,000)	<u>45,000</u>

3. (a) Treatment of losses and capital allowances of pioneer period losses

- (i) 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 Section 10(6);
- (ii) 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:
 - remuneration to directors of the company;
 - 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)).
- (iii) 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));
- (iv) 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;
- (v) 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

- (i) No capital allowance shall be claimed during the pioneer period.
- (ii) 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.
- (iii) 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.

- (b) 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.
- (c) 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.
- (d) The accounting period shall be:
 - A period not exceeding one year, commencing on its production day;
 - a successive period of one year thereafter; and
 - a period not exceeding one year ending at a date when its tax relief period ends.

(4)

KAK Professional Services (Tax Consultants)
22, Ikorodu Road, Lagos

April 9, 2025

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 April 7, 2025, 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) Various tax incentives

(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 relate to 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 ₦25 million or less turnover is exempted from companies income tax while, any company with annual gross turnover of more ₦25 million but less than ₦100 million attracts income tax rate of 20% on total profit;

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.

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.

(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 utilisation 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, 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

Wasiu Sanyaolu
Principal Consultant

(5) 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.
- (iv) 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; and

(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 fulfil 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.

6.

Lazarus Nigeria Limited

Computation of tax liabilities

For the relevant years of assessment

	₦	₦
2022 assessment year		
Assessable profit (01/07/21 – 31/12/21)		15,000,000
Less Section 17 Account		<u>2,000,000</u>
Adjusted profit		13,000,000
Less capital allowance		<u>12,720,000</u>
Total profit		<u>280,000</u>
Tax @ 30%		<u>84,000</u>
Tertiary education tax (2.5% of ₦15,000,000)		<u>375,000</u>
2023 assessment year		
Assessable profit (01/01/22 – 31/12/22)		16,000,000

Less capital allowance	<u>2,800,000</u>
Total profit	<u>13,200,000</u>
Tax @ 30%	<u>3,960,000</u>
Tertiary education tax (3% of ~~N~~ 16,000,000)	<u>480,000</u>

2024 assessment year

Assessable profit (01/01/23 – 31/12/23)	16,800,000
Less capital allowance	<u>2,800,000</u>
Total profit	<u>14,000,000</u>
Tax @ 30%	<u>4,200,000</u>
Tertiary education tax (3% of ~~N~~ 16,800,000)	<u>504,000</u>

Workings

Section 17 Account

Adjusted profit/Loss

	N
Year ended 30/06/19	6,000,000
Year ended 30/06/20	5,000,000
Year ended 30/06/21	<u>(13,000,000)</u>
	<u>(2,000,000)</u>

CAPITAL GAINS TAX

Contents

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11 Capital Gains Tax

11.0 Learning objective

The objective of this chapter is to enhance readers' understanding of capital gains tax in Nigeria.

11.1 Learning outcomes

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.

11.2 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).

11.3 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 regard 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 of 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.

11.4 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.

11.5 Rate of tax and date of payment of tax due

Capital gains tax (CGT) is chargeable at 10% on capital gains arising from disposal of assets (20% applied up to 31/12/1995).

In line with the provisions of Section 2 of the Finance Act, 2020 (which amended Section 31 of Capital Gains Tax, 2004), every person having disposed a chargeable asset shall not later than June 30 and December 31 of that year, compute the capital gains tax, file self-assessment return, and pay the tax computed in respect of the chargeable assets disposed in the periods.

11.6 Computation of chargeable gains

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 from 1/1/1998).

Section 4 provides that, where the disposal of assets is by an individual:

- (a) (i) who is in Nigeria for some temporary purpose only and not with any view or intent to establish his residence in Nigeria; and
- (ii) if the period or sum of the periods for which he is present in Nigeria in that year of assessment exceeds 182 days, or
- (b) where the disposal is by any trustee of any trust or settlement and the seat of administration of the trust or settlement is situated outside Nigeria during the whole of that year of assessment; or
- (b) where the disposal is by a company, which is not a Nigerian company, within the meaning of section 105 of CITA 2004, that is to say, a company whose activities are managed and controlled outside Nigeria, during the whole of the year of assessment, capital gains tax shall be charged 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.

Section 5 of Capital Gains Tax Act, 2004 on Capital loss on disposal of any asset, which hitherto is not deductible from capital gains on disposal of any other asset even if both are of the same type is repealed and substituted by Section 3 of the Finance Act, 2023.

Section 3 (sub-sections 1 and 2) of Finance Act, 2023 provides that:

- (i) in computation of chargeable gains under this Act, the amount of any loss which accrues to a person on the disposal of any asset shall be deductible from gains accruing to the person disposing that asset, provided that such loss shall only be deductible against the same type of asset; and
- (ii) where the aggregate capital losses by any taxable person in a tax year exceeds the aggregate chargeable gains, such loss may be carried forward for deduction from chargeable gains arising from the disposal of the same type of asset in the following year and so on, provided that such losses shall only be carried forward for a maximum of five years immediately succeeding the year in which the loss was incurred.

11.7 Exemptions from capital gains tax

The following are exempt chargeable gains:

- (a) Gains accruing to:
 - (i) an ecclesiastical, charitable or educational institution of a public character;
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)).

- (b) Gains accruing to any Local Government Council (Section 28(1)).
- (c) 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 (Section 28(2)).
- (d) 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 (Section 29.1).
- (e) 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.
- (f) 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).
- (g) 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.
- (h) Gains accruing on disposal of land compulsorily acquired by an authority having and exercising such powers (Section 9).
- (i) 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 (Section 33).

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 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 (Section 38).
- (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 (Section 32A).
 - gains arising in respect of disposals of securities in a Unit Trust provided the proceeds are re-invested (Section 32B) Stocks and shares of every description are exempted from 1 January, 1998.

11.7.1 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.

11.8 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 (Section 11).

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 11.1

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 N25,000. The cash price of the asset is ~~N~~790,000.

Required:

Calculate the capital gains tax due assuming the assets were sold as follows:

- (a) for ~~N~~1.25million after payment of twenty-four instalments.

- (b) for ~~N~~1.3 million after full payment of all the instalments.

Solution to illustration 11.1

	N'000	N'000	N'000
(a) Disposal after 24 instalments paid			
Sales price			1,250
Less: Cost of the asset:			
Deposit		250	
Instalments paid totaled (24 x ~~N~~ 25,000)	600		
Less: interest element (24 x ~~N~~ 10,000)	<u>240</u>	<u>360</u>	<u>(610)</u>
Capital Gains:			<u>640</u>
Capital Gains Tax 10% thereof			<u>64</u>
(b) Disposal after full payment of all instalments Sales price			
Sales price			1,300
Less: Cost:			
Deposit		250	
Instalments paid (36 x ~~N~~ 25,000)	900		
Less interest element (36 x ~~N~~ 10,000)	<u>360</u>	<u>540</u>	<u>790</u>
Capital Gains			<u>510</u>
Capital gains tax 10% thereof			<u>51</u>
(c) Calculation of interest element of each instalment			
Deposit		250	
Total payable by instalments (36 x 25)		900	
Total hire-purchase price			1,150
Less: the cash price			<u>790</u>
Total interest element			<u>360</u>
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 apportionable 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:

$$\frac{A}{C} \times C + B$$

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 (Section 24)

- (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 (Section 7(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 (Section 13).

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 in consequence (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; (subsection 1).

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, (subsection 4).

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, (subsection 7).

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.

11.8.1 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 in respect to the consideration which has been so applied, be treated for CGT purposes as if the:

- (a) consideration for the disposal of the old asset was (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 was 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 11.2

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.

Solution to illustration 11.2

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 paragraph(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 was 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 paragraph (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

Class 5 assets - Stocks and shares (see Section 4 of Finance Act, 2023)

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).

11.9 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.

11.10 Offences and penalties

There are 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.

11.11 Other matters

11.11.1 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 was 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)).

11.11.2 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 (Section 25).

11.11.3 Assets located outside Nigeria (Section 4)

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.

11.11.4 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.

11.11.5 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).

11.12 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 provisions of the Finance Act 2023, in respect of capital loss on disposal of an asset was also discussed.

Readers must have also learnt the amendments to relevant sections of the Capital Gains Tax Act by the Finance Act, 2019 and Finance Act, 2020.

11.13 Worked examples

11.13.1 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 in March 2017. The amount formed part of the cost of construction of the new factory at Ejigbo which was completed in November 2017, at a cost of ₦5,600,000.

In 2018, 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 2018, 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 2018. Its original cost was ₦850,000 and 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, 2018. The company decided to move to Ogun State between September and November 2018. 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) Explain one other alternative open to Janid Investments Limited in discharging its capital gains tax liability and the time limit for exercising the option.

3. Meltdown Construction Limited purchased a bulldozer on hire purchase on February 1, 2017, 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, 2017.

Required:

Compute the capital gains tax for the relevant year of assessment, assuming that the bulldozer was sold for:

- (a) ₦48,400,000 after the payment of instalments on December 3, 2017.
- (b) ₦49,600,000 after the payment of instalment on September 5, 2018.

4. White Cleaners Ltd. is involved in dry cleaning business. The company acquired a building for the business within Shonibare Estate, Maryland, in the year 2021 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 2023 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.

Required:

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.

11.13.2 Suggested solutions to questions

1.

XYZ & Co. (Chartered Accountants)
2, Ayodeji Street, Ikeja, Lagos State

O/R/Y/R

November 15, 2019

The Managing Director
Best Manufacturing (Nig.) Ltd. Ejigbo
Lagos State

Dear Sir,

RE: Advice on Tax Implications of the Disposal of Property and Insurance Claims Received on Destroyed Property

We are in receipt of your letter dated November 5, 2019, appointing us as your company's Tax Consultants and specifically requesting for our advice in respect of the above subject matter.

After thorough examination of the information provided in your letter under reference, we wish to report as follows:

(a) Capital gains (if any) arising from the transactions

Please find attached Appendix I, detailing the capital gains for 2017 and 2018 assessment years.

(b) The capital gains tax payable

For 2017 assessment year, the company was not liable to capital gains tax while for 2018 assessment year, the capital gains tax was N130,000. Please see Appendices I and II, for the details.

(c) Suggestions on ways of reducing the capital gains tax

In our opinion, for your company to have a reduced capital gains tax liability, the full proceeds of N5,900,000 should be applied to Ejigbo factories, thus having a full benefit of roll over relief in 2018 assessment year.

We have based all our computations on the tax provisions relating to:

- (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 2018, 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 for the confidence reposed in us.

Yours faithfully,

For: XYZ & Co. (Chartered Accountants)

P. James

Managing Partner

Best Manufacturing Nig. Ltd.

(a) Appendix I

Capital Gains for 2017 year of assessment	N'000
Disposal of OTA warehouse	
Sales proceeds	4,200
Less: Cost of acquisition	(1800)
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	<u>Nil</u>

- ii. **Reason:** The amount reinvested is greater than the sale proceeds;
therefore, full roll-over relief will be claimed.

(b) Capital Gains for 2018 year of assessment	
Disposal of Ota factory	N'000
Claim for Macon	5,900
Less: Cost of acquisition	<u>(3,700)</u>
Capital gains	<u>2,200</u>

Deduct roll-over relief:	
The lower of:	
Amount re-invested	<u>4,600</u>
Claim/sales proceeds	5,900
Less: Cost of acquisition	3,700
Capital gains rolled over	<u>(900)</u>
Net capitals gains	<u>1,300</u>

Total capital gains made on the project	
2017 year of assessment – Disposal of warehouse	2,400
2018 year of assessment – Disposal of factory	2,200

Appendix II

Capital gains tax payable

2017 Year of assessment	Nil
2018 Year of assessment (~~N~~ 1,300,000 x 10%)	130

(c) Ways to reduce the capital gains tax

In order to reduce the capital gains tax, the full proceeds of N5,900,000 should be applied to Ejigbo factories so that the company can benefit from full roll-over relief in 2018 assessment year.

2

(a)

Janid Investments Limited Computation of capital gains tax liability For 2018 year of assessment

	Lagos building ~~N~~	Ibadan building ~~N~~
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	<u>22,500,000</u>	<u>11,400,000</u>
Capital gains tax (10%)	<u>NIL</u>	<u>1,140,000</u>

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.

- (b) 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.”

3. Meltdown Construction Limited

(a) Computations of capital gains tax
For 2017 year of assessment

	N	N	N
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)	<u>(1,750,000)</u>	<u>8,250,000</u>	<u>(36,750,000)</u>
Chargeable gains			<u>11,650,000</u>
Capital gains tax thereon @ 10%			<u>1,165,000</u>

(b) Computations of capital gains tax
For 2018 year of assessment

	N	N	N
Sales proceeds of bulldozer			49,600,000
Cost of bulldozer			
Deposit paid		28,500,000	
Instalments paid (19 months @ N1,000,000 each)	19,000,000		
Less interest portion paid (W3)	<u>(3,325,000)</u>		
		<u>15,675,000</u>	<u>(44,175,000)</u>
Chargeable gains			<u>5,425,000</u>
Capital gains tax thereon @10%			<u>542,500</u>

Working notes

(W1) Calculation of hire purchase interest

Hire purchase price;	
• Deposit (1/2/2017)	28,500,000
• 20 instalments payable (March 2017 to October 2018) @ N1,000,000 per month	<u>20,000,000</u>
	48,500,000
Cash price	<u>45,000,000</u>
Hire purchase interest for 20 months	<u>3,500,000</u>

(W2) Calculation of hire purchase interest up to 1/12/2017

Hire purchase interest payable ~~₦~~3,500,000

$$\begin{aligned}\text{Hire purchase interest at the time of disposal} - 3/12/2017 &= \frac{\text{N}3,500,000 \times 10}{20} \\ &= \text{N}1,750,000\end{aligned}$$

(W3) Calculation of hire purchase interest up to 1/10/2018

$$\begin{aligned}(\text{that is, } 5/9/2008) &= \text{N}175,000 \times 19 \text{ months} \\ &= \text{N}3,325,000\end{aligned}$$

4.

White Cleaners Ltd.

**(a) Computation of capital gains
For 2023 assessment year**

Building	₦
Proceeds from disposal	30,000,000
Cost of acquisition	<u>(25,000,000)</u>
Capital gains	<u>5,000,000</u>
Equipment	
Proceeds from disposal	3,500,000
Cost of acquisition	<u>(5,000,000)</u>
Capital loss	<u>(1,500,000)</u>
Generating set	
Proceeds from disposal	4,300,000
Cost of acquisition	<u>(3,500,000)</u>
Capital gains	<u>800,000</u>
Total capital gains	<u><u>5,800,000</u></u>

(b) Computation of 'roll over relief'

(i) Building	₦
Proceeds from disposal	30,000,000
Cost of acquisition	<u>(25,000,000)</u>
Capital gains	<u>5,000,000</u>
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 ~~N~~

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 for ~~N~~65,000,000, hence the ~~N~~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

	~~N~~	~~N~~
Proceeds from disposal	4,300,000	
Cost of old generating set Rollover relief:	<u>(3,500,000)</u>	800,000
The lower of:		
Amount reinvested in the new set		3,000,000
Actual sales proceeds	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:

	N
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.

TAXATION OF LEASES

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12 Taxation of Leases

12.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the basic principles and application of taxation of leases.

12.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

- a) understand the basic concept of accounting for lease transactions;
- b) ascertain the various classifications of leases;
- c) know the various tax implications of lease transactions;
- d) understand the treatment of capital allowances under lease arrangements;
- e) understand the leasing as a separate line of business;
- f) ascertain the recognition, measurement, presentation and disclosure of leases by corporate entities;
- g) know the treatment of COVID-19- related rent concessions;
- h) understand the Interest rate benchmark reform;
- i) ascertain lessor's forgiveness of lease payments;
- j) understand lease term and useful life of leasehold improvements; and
- k) know lease liability in a sale and leaseback.

12.2 Concept of leases

SAS 11 defines Lease as "a contractual agreement between an owner (The Lessor) and another party (The Lessee) which conveys to the lessee the right to use the leased asset for consideration usually periodic payments called rents". A lease can also be defined as an agreement wherein a lessor (owner) lets out an asset to a lessee in exchange for a consistent rental payment for an agreed period. It is an agreement where one party (the lessee) agrees to pay a specified rent for the use of a specific asset owned by another party (the lessor) for a fixed term. For accounting purposes, a lease can be a finance lease (being a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee) or an operating lease (being a lease that does not transfer substantially all the risks and rewards of ownership of an asset to the lessee).

International Financial Reporting Standard (IFRS) 16 brings about significant changes to both the income statement and statement of financial position of the lessee. It became effective 1 January 2019.

12.3 Accounting for lease transactions

The International Financial Reporting Standard (IFRS) 16 on accounting for leases recommends a single lease accounting model, requiring a lessee to recognise a Right-of-Use (ROU) asset and a lease liability for all leases unless the lease term is 12 months or less, or the asset has a low value. For accounting purposes, a lease can be classified as either a finance lease or an operating lease.

Upon lease commencement, a lessor shall recognise assets held under a finance lease as a receivable at an amount equal to the net investment in the lease. A lessor recognises

finance income over the lease term of a finance lease, based on a pattern reflecting a constant periodic rate of return on the net investment. At the commencement date, a manufacturer or dealer lessor recognises selling profit or loss in accordance with its policy for outright sales to which IFRS 15 applies. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.

Basically, two types of lease exist for tax purpose. A lease is either a tax lease or a non tax lease. A tax lease is one which qualifies for tax purposes while the non tax lease is one which is considered to be a loan. Guidelines have been made to distinguish between these two types of leases. If a lease has features such as a purchase option that indicate ownership, it will be treated as a purchase or loan. Thus, it could be said that a finance lease under this circumstance would not qualify as a true lease, since the true intention of the parties is for the lessee to own the asset at the end of the transaction. Operating lease is regarded by the tax authorities as a true lease and would entitle the lessor to claim capital allowance, depreciation and the lessee, the rent expense.

12.4 Classes of leases

Lessors shall classify each lease as a finance lease or an operating lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise, a lease is classified as an operating lease.

12.4.1 Finance Lease

Finance Lease is a lease involving rental payment over an obligatory period sufficient in total to amortise the capital outlay of the lessor and give the lessor some benefits. For a lease to qualify as a finance lease, consideration is given to its effective life, the option to purchase the property and the estimated residual life of the property. Based on the above statement the taxpayers can distinguish between finance and operating leases which results in different tax implications.

A lease is typically classified as a finance lease for accounting purposes where the lease is considered to have transferred substantially all the risks and rewards incidental to ownership of the leased asset from the lessor to the lessee. Whether the risks and rewards have transferred such that the lease should be classified as a finance lease for accounting purposes is a judgment made by a suitably qualified accountant based on the substance of the transaction (rather than the legal form of the arrangement).

Lease rental is made up of the interest and capital portions. The interest portion of the rental earned by the lessor, constitutes taxable income in the hand of the lessor and the capital portion is a repayment of initial investment and has no tax implication. Also, the lessor is not allowed to claim capital allowance on the leased assets. Only the lessee is allowed to make such claim. If the lessor makes such claim, it will be disallowed by the FIRS. The basis for this, is that the lessee is regarded in substance as the owner of the asset since all risks and rewards of ownership are transferred to him.

A finance lease involves the lease of an asset, such as machinery, to a commercial customer under an arrangement which is non-cancellable or only cancellable on payment of a financial penalty. The lessor provides the funding for the equipment, but maintenance is done by the lessee. The lessee has an option to purchase the equipment. The equipment remains property of the lessor until the end of the agreement or when the asset is duly paid for by the lessee.

Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are set out below:

- a) The lease transfers ownership of the asset to the lessee by the end of the lease term.
- b) The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than fair value at the date the option becomes exercisable meaning that, at the inception of the lease, it is reasonably certain that the option will be exercised.
- c) The lease term is for a major part of the economic life of the asset, even if title is not transferred at the inception of the lease.
- d) At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.
- e) The leased assets are of a specialised nature such that only the lessee can use them without major modifications being made.

In summary, a finance lease is a lease in which risks and rewards of ownership are transferred to the lessee, who is under obligation to pay such costs as insurance, maintenance and similar charges on the asset in addition to periodic lease rentals. In most cases, a finance lease agreement is non-cancellable, and the Lessee has an option to buy the asset for a nominal amount at the expiration of the lease term. The agreement usually provides for the payment of periodic rentals to cover capital repayment and interest computed at specific rates.

Features of finance lease

- a) It is non-cancellable.
- b) Lease term covers substantially (80% or more) of the useful life of the asset; or net present value of the lease at inception, using the minimum lease payments and the implicit interest rates; or the lease has a purchase option which is likely to be exercised.
- c) The ownership risks and rewards are transferred to the lessee; and
- d) The lessee is under obligation to pay such cost as insurance, maintenance and similar charges on the asset.

Accounting treatment of finance leases

In accounting for a finance lease, both the lessor and the lessee will typically treat the transaction substantively as if it was the financed sale of the asset to a lessee (or the

provision of finance to the lessee to allow them to purchase the asset) with the accounting profits arising from the transaction computed on that basis.

The lease rental payments receivable are treated as comprising both a capital repayment and an interest/ finance charge element with:

- a) the interest/finance charge element being recorded as income in the profit and loss account, and
- b) the capital element reducing the amount receivable in the statement of financial position.

Similarly, the lessee will not treat the finance lease as a simple rental arrangement in their accounts and will instead recognise:

- a) their right to use the leased asset as an asset on their statement of financial position, and
- b) their obligation to pay future lease rentals as a lease creditor.

The “**right of use**” asset is depreciated over the shorter of the lease term and the normal useful life of the actual asset. The lease payments made by the lessee will also be treated as comprising a capital and financing charge element with:

- a) the finance charge element recorded as an expense in the statement of comprehensive income, and
- b) the capital element reducing the lease creditor payable in the statement of financial position.

12.4.2 Operating lease

An operating lease for accounting purposes is a lease that has not been classified for accounting purposes as a finance lease. It is any other lease other than a finance lease. Under such an arrangement, the Lessor, while granting the Lessee the right to use the leased property, retains ownership of the property, risks, obligations and benefits associated with ownership in addition to the lease rentals that he receives.

An operating lease is a contract under which the asset is not wholly amortized during the primary period of the lease, and where the lessor does not rely solely on the rentals during the primary period for their profits but looks for the recovery of the balance of their costs and for the rest of their profits from the sale or re-lease of the returned asset of the primary lease period

Features of an operating lease

- a) The risk and ownership of the asset remains with the lessor.
- b) The lease is for a shorter period than in a finance lease though the life span of the lease may not be known at the beginning.
- c) The lease may be cancelled or renewed as may become necessary.
- d) The lessor is under obligation to pay such cost as insurance, maintenance and similar charges on the asset.
- e) The lessee is not entitled to claim capital allowances since the lessor claims allowances in respect of the leased asset.

- f) The interest expense in the income statement is tax deductible. However, the depreciation charged for the right of use asset is not a tax-deductible expense.

Accounting treatment of operating leases

How an operating lease is treated for accounting purposes is dependent on the following factors:

- a) whether the accounts are being prepared by the lessor or the lessee, and
- b) the accounting standards used to prepare the financial statements.

The lessor will generally:

- a) record lease income as income in the profit or loss account on a straight-line basis (or some other systematic or rational basis for example, reducing balance), and
- b) depreciate the leased asset in accordance with accounting standards.

12.4.3 Other variants of finance lease

- a) **Leverage lease** is a three-party arrangement involving a lender (often a financial institution) in addition to the usual lessor or lessee. In most cases, the lender provides the greater part of the purchase price of the leased asset.
- b) **Sales-type lease** is one where the lessor transfers substantially all the ownership risks and benefits of the property to the lessee. At the inception of the lease, the fair value of the leased property is greater or less than its carrying amount in the books of the lessor resulting in a profit or loss to the lessor who is often a manufacturer or dealer.
- c) **Sub-leases** is a lease agreement that allows the lessee to sub-lease to a third party who becomes a sub-lessee. In such a case, the original lessee becomes the lessor and all or some of the rights or obligations under the original lease are transferred to the new lessee. According to Statement of Accounting Standards on leases, SAS 11, the accounting treatment of a sub-lease is not different from that accorded to a normal or original lease because there is a lessor and a lessee, respectively. The original lessee treats all the transactions pertaining to a sub-lease as a lessor while the sub-lessor treats them as a lessee accordingly. The initial lessee continues to account for the original lease as a lessee.
- d) **Sale and leaseback** is one in which the seller of the property leases it back from the buyer. This kind of arrangement is like borrowing money and pledging the fixed asset in question. A company which engages in this type of arrangement stands to enjoy the following benefits:
 - i) the company realizes money from the sale;
 - ii) the company may also make balancing allowances there from;

- iii) the company enjoys capital allowances from the asset despite the disposal since it has been leased but this has to be finance lease to be so; and
- iv) the instalmental payments being made by the company is tax deductible.
- v) this arrangement can be used as a means of financing a company as well as tax savings.

12.5 Tax implications of lease transactions

12.5.1 Finance (capital) lease

a) Tax issues for the lessor

i) Companies income tax (CIT)

- The interest portion of the rent earned by the lessor constitutes taxable income in the hand of the lessor;
- Capital portion is a repayment of initial investment and has no tax implication;
- The lessor is not entitled to claim capital allowances on the leased assets; only the lessee is entitled to make such claims. (If the lessor makes any such claim for capital allowances, FIRS will disallow it).

ii) Withholding tax (WHT)

Withholding tax is computed only on the interest portion of the total lease payment due from the lessee. The lessor will receive lease rent less 10% WHT. The credit note will be issued in the name of the lessor who can use it to offset its income tax liability for the relevant period.

iii) Value added tax (VAT)

Interest earned by the lessor on finance lease is a return on investment and is not liable to VAT.

iv) Capital gains tax (CGT):

If the asset is disposed at the expiration of the lease period, any capital gain realised would be subject to capital gains tax.

b) Tax Issues for the lessee

i) Companies income tax (CIT)

- The Interest portion of the periodic lease rent and other related expenses such as maintenance cost and insurance are deductible expenses for income tax purposes.
- The lessee is entitled to claim capital allowance on capital portion of the value of the leased assets.

ii) Withholding tax (WHT)

The lessee has a duty to withhold tax at 10% on the interest portion of the lease rental and to remit same to FIRS.

iii) Value Added tax (VAT)

The input tax incurred on purchase of the assets is to be capitalised with the cost of the asset.

iv) Capital gains tax (CGT)

Capital gains tax will not be applicable to the lessee unless the gain arose from the sale of his interest in the lease. However, he will be liable to capital gains tax if the leased asset was sold by him after exercising the purchase option.

12.5.2 Operating lease

a) Tax issues for the lessor

i) Companies income tax (CIT)

- The total lease rental received or receivable by the lessor is income and it is wholly taxable
- The lessor is entitled to claim capital allowance on the leased assets.

ii) Withholding tax (WHT)

Withholding tax computed on the total lease rental must be deducted from the sums due from the lessee. The withholding tax due is at 10% of the total rental income due on the lease.

iii) Value added tax (VAT)

The lease rental income is liable to VAT; the lessor is to include a 7.5% VAT charge on its invoice to the lessee.

b) Tax implication for the lessee

i) Companies income tax (CIT)

- The rental charges and other associated expenses are allowable deductions for tax purposes.
- Capital allowances can only be claimed by the lessor; capital allowances should not be claimed by the lessee on assets under operating lease.

ii) Withholding tax (WHT)

The lessee shall withhold tax at 10% from the rental payment to the lessor and remit same to the relevant tax authority.

iii) Value added tax (VAT)

VAT charged by the Lessor on the lease rental charge is not an input tax to the Lessee; it is to be charged to the profit or loss account.

12.5.3 Practical steps to manage tax impacts

- a) Identify all leases:** Pull together a comprehensive lease inventory. This should include obvious long-term real estate leases and any equipment or vehicle leases that run beyond 12 months.

- b) **Review and classify for tax purposes:** Distinguish leases that qualify as true (operating) leases from those that count as non-tax (or finance) leases. This classification dictates whether the lease produces rental deductions or depreciation and interest.
- c) **Implement a tracking system:** Investing in lease management software can streamline how you capture key data points from initial entries to ongoing payments and automatically generate reconciliations between book and tax treatments.
- d) **Monitor and reconcile book-to-tax differences:** Maintain detailed schedules for changes in right-of-use assets, lease liabilities, deferred rent eliminations, and interest expense permutations. These schedules will feed into deferred tax calculations and assist in year-end (or interim) reviews.
- e) **Stay current with rules:** Tax law is dynamic, keep an eye on potential federal or state changes that could alter how various leases are treated. Also, remain alert to international standard changes if you have global footprints under IFRS 16.

12.6 Capital allowances under lease arrangements

12.6.1 Capital allowance under finance lease arrangement

In the case of a finance lease, paragraph 18 (2) of the Second Schedule to Companies Income Tax Act, 2004 (as amended) provides that “where however an asset is acquired by any hirer or lessee under a finance lease contract the term of which provide for the transfer of ownership, risks and reward to the hirer or lessee, the provisions of this schedule shall in the same way as it applies to an asset acquired by any owner or lessor of an asset for the purpose of his trade or business, but shall so apply subject to the following modifications:

- a) the qualifying expenditure within the provisions of this schedule shall in relation to any asset so acquired under that contract, be limited to the amount of the total lease payments due from the hirer or lessee, during his basis period excluding in the computation of such qualifying capital expenditure any interest or charges payable under the contract; and
- b) any reference in this subparagraph to any owner/lessor of any asset shall be construed as including a reference to a hirer or lessee under finance lease contract and as excluding a reference to the person leasing the asset to the hirer or lessee under the contract.

Following from the foregoing provision, the claim for capital allowances under a finance lease arrangement can only be made by the lessee. The Act further states that the qualifying expenditure shall be limited to the total lease payments due from the lessee to the lessor; in effect interest charges payable by the lessee to the lessor is not a qualifying capital expenditure and does not qualify for capital allowances.

12.6.2 Capital allowance under operating lease arrangements

Paragraph 18(1b) of the second schedule to the Companies Income Tax Act provides that “where a company owning an asset leases that asset to any person under an operating lease contract for use wholly, exclusively, necessarily and reasonably, for the purpose of a trade or business carried on by such person, the provision of this schedule shall apply as though the expenditure were incurred for the purpose of a trade or business carried on by the owner or lessor and as though the owner or lessor were using the asset for the purpose of such last mentioned trade or business in the way in which and for the period or periods during which the asset is in fact in the first- mentioned trade or business”. In essence, capital allowances can only be made by the lessor under an operating lease arrangement.

12.7 Lease as a separate line of business

In Nigeria, leasing can be a lucrative business, providing individuals and companies with access to assets without the need for outright purchase. Leasing is a growing market in Nigeria. According to a report released by the Equipment Leasing Association of Nigeria (ELAN), the Nigerian Leasing industry recorded an increasing growth rate. Leasing business is important to the Nigerian economy because it increases capital investment and economic growth and enables businesses and even governments (at the local and national level), to acquire capital assets for production.

Leasing means the business of letting or sub-letting movable property on hire for the purpose of the use of such property by the hirer or any other person in any business whatsoever and where the lessor is the owner of the property regardless of whether the letting is with or without an option to purchase the property. This definition is encompassing of the business of rentals, operating leases, finance leases conditional sale and hire purchase. However, the above businesses are differentiated by the terms of contract as agreed between parties. A contract of rent is typically that of hire or letting of property for a short period of time and for all time from hours to a month and sometimes a longer period based on more frequently received rentals and the incidence of maintenance of the property lies with the hirer for the period of the rental.

12.7.1 Structure of leases in Nigeria

A lease arrangement may take the form of any of:

a) Finance lease

A financial lease is also known as a capital or full pay out lease. This is a contract involving payment over an obligatory period (known as the primary or basic period) of specific sums sufficient in total to amortise the capital outlay of the lessor. The lessee in finance lease arrangement usually has a choice after the expiration of the primary period of either purchasing the asset or extending the lease over a secondary period. It is similar to purchasing an asset with a loan and paying back the loan in instalments including the accrued interest. However, it differs from a hire purchase or conditional sale which from initiation of the contract, the hirer agrees to purchase the asset, and the owner merely transfers the asset at the end of the period after all instalments have been paid.

Features of finance lease

- (i) The lessee and lessor are obligated to the lease and cannot cancel it except by mutual consent before the expiration of its tenor.
- (ii) Finance lease usually last for a longer period. It is drawn in such a way as to cover substantially the economic life of the asset during which the lessee must fulfill the obligations of the lease.
- (iii) The total lease rentals in a finance lease are usually higher than the original value of the leased asset. This is to cover all attendant costs and expenses and the lessor's return on investment during the tenor of the lease. The salvage of the asset is extra profit to the lessor.
- (iv) Generally, the lessee is responsible for the maintenance of the asset.

b) Operating lease

An operating lease is a contract between a lessee and a lessor under the terms of which the lessor permits the use of an asset without transferring the ownership rights of the subject matter asset to the lessee. In an operating lease, the true value or cost of the asset is not fully paid up or written off by the rental payments made during the subsistence of the lease. This means that the asset is not entirely amortized during the lease period.

Operating lease is for a shorter period than the asset's economic life cycle, and after the first term has passed, the asset may be subsequently leased after the expiration of the lease period. It can be cancelled before the end of its tenor by either party and the lessor retain ownership, risks and benefits accruing to it. This may be differentiated from a contract for rent which is typically that of hire or letting of property for a short period of time and for all time from hours to a month and sometimes a longer period of time based on more frequently received rentals and the incidence of maintenance of the property lies with the hirer for the period of the rental.

In an operating lease, the asset is not entirely amortized during the primary period (if any) of the lease and in which the lessor seeks to recover the cost and profit from the sale of the returned asset at the end of the lease period rather than relying on rentals during that time.

The lessor is entitled to receive lease rentals for the lease period; the lease rental is determined by several factors and the base value of the asset. The lessor may also earn additional income through charges for added services such as asset maintenance, insurance and technical support that may be provided during the lease period by the lessor.

Features of operating lease

- i) The lessor bears the responsibility for servicing and maintaining the asset and these costs are included in the lease rental. It enables the lessor to keep a pool of qualified maintenance personnel for cost-effectively maintaining many assets.

- ii) The total lease rentals in an operating lease are typically lower than the cost of the asset.
- iii) The lessor or lessee can cancel the lease before the expiration of the primary lease period.
- iv) The lessor may provide extra services relating to the asset such as insurance, product warranties, replacements (i.e. replacing the leased asset with another pending major repair on the asset) and other technical and operational support.
- v) In a full-service operating lease, the lessor is directly affected by the state and efficiency of the asset. The lessor therefore has a great interest in ensuring the asset is kept in good condition.

12.7.2 Benefits of leasing

Running a business means making smart choices with resources. One of the most strategic decisions to consider by a company is leasing equipment instead of buying it. As a business owner, it's crucial to understand the benefits of leasing and how it can help save the business money, keep technology fresh, and make business more flexible. Some of the key benefits are outline below:

- a) **Cash flow preservation:** Leasing equipment offers a significant advantage of relieving the immediate financial pressure on business, freeing up cash for other critical investments, whether expanding product line, boosting marketing efforts, or covering unexpected expenses. Leasing enables the entity to spread out the equipment costs over time, helping it to maintain a healthy cash flow and ensure the stability of the business finances.
- b) **Tax and accounting advantages:** Leasing can offer significant tax benefits for business. Lease payments are typically treated as tax-deductible operating expenses, reducing the overall tax liability. Additionally, leased equipment does not appear as a capital asset on the statement of financial position, improving the financial ratios and attractiveness to investors and lenders.
- c) **Alternative to financing:** Securing financing can pose challenges, leasing provides a more accessible alternative, allowing the entity to acquire the required equipment to operate and grow the business without the barriers of traditional financing options. With simplified approval processes and flexible payment terms, leasing streamlines the financing process.
- d) **Access to newer technology:** Keeping pace with technology is not just a necessity but a competitive advantage for businesses. However, investing in the latest equipment can be expensive. Leasing offers a financially efficient solution, enabling the entity to access the latest models as they become available.
- e) **Scalability and agility:** Leasing provides business with both scalability and flexibility by offering solution that adjusts to changing needs without the financial burden of purchasing expensive equipment outright. Whether the entity is experiencing rapid growth, expanding operations, or facing fluctuating demand,

leasing enables efficient scaling. Additionally, it enhances business agility by allowing quick adaptation to market demands without the long-term commitment of ownership.

12.7.3 Regulatory framework of leasing business in Nigeria

In Nigeria, the regulatory framework for leases is influenced by international standards, including IFRS 16. The Financial Reporting Council of Nigeria (FRC) adopts these standards, which guide the accounting treatment for leases and leasehold improvements.

The regulatory laws are:

- (a) Equipment Leasing Act 2015;
- (b) Banks and Other Financial Institutions Act 2020; and
- (c) Central Bank of Nigeria (CBN) Revised Guidelines for Finance Companies in Nigeria 2014

The regulatory bodies are:

- (a) Equipment Leasing Regulatory Authority (ELRA);
- (b) Central Bank of Nigeria (CBN);
- (c) Banks and other Financial Institutions Act 2020 (BOFIA); and
- (d) The Nigerian Deposit Insurance Corporation (NDIC).

12.7.4 Licensing and registration regime

The business of Equipment Leasing is regulated by the provision of the Equipment Leasing Act 2015 (ELA) which seeks to regulate the business of equipment leasing in Nigeria such that the relationship between the lessor and the lessee and relationship with third parties is protected by the Equipment Leasing Regulatory Authority (ELRA) which was inaugurated on Friday 19th May, 2023 by the Minister of Finance, Budget and National Planning. In this regard, the ELA provides that an equipment lease agreement shall irrespective of the value of the leased equipment, be registered with the ELRA not later than 14 days after the commencement of such lease agreement, or within three months for a lease agreement made before the Commencement of the ELA. Non-registration of a registrable lease agreement shall render the lease agreement invalid as between the parties to the agreement but shall render same unenforceable against any third party acting in good faith, for value without notice of the lease agreement.

Section 6 of the ELA provides that a person may only carry on the business of equipment leasing if:

- a) It is a limited liability company and the MEMART expressly provides that it will carry on the business of equipment leasing; and
- b) It has satisfied all requirements prescribed by the guidelines made from time to time by the ELRA.

The CBN regulates companies that carry on business in the form of finance leases. Whilst the CBN does not regulate operating leases, it is important to note that where a regulated business carries on both operating lease and finance lease business and there is no distinction in the lines of business, the CBN will regulate the lease business. Leasing

companies that engage in finance leases are required to apply for a licence to carry on the business as a finance company regulated by the CBN and comply with the prudential/regulatory requirements for Finance Companies as defined by the CBN.

12.7.5 Challenges

- a) **Regulatory:** Leasing companies in Nigeria must comply with regulatory requirements, which can be complex and time-consuming.
- b) **Risk management:** Leasing companies must manage risks associated with asset ownership, such as maintenance and obsolescence.
- c) **Funding:** Leasing companies require access to funding to purchase assets and provide leasing services.

12.8 Recognition, measurement, presentation, and disclosure of leases by corporate entities

IFRS 16 establishes the principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions.

IFRS 16 Leases applies to all leases, including subleases, except for:

- a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- b) leases of biological assets held by a lessee (*Agriculture*);
- c) service concession arrangements (*Service Concession Arrangements*);
- d) licences of intellectual property granted by a lessor (see *Revenue from Contracts with Customers*); and
- e) rights held by a lessee under licensing agreements for items such as films, videos, plays, manuscripts, patents and copyrights within the scope of Intangible Assets.

A lessee can elect to apply IFRS 16 to leases of intangible assets, other than those items listed above.

12.8.1 Recognition and measurement

- i) **Lessee:** Recognises lease assets and liabilities on the statement of financial position, with the lease asset measured at the present value of the minimum lease payments or the fair value of the asset, whichever is lower.
- ii) **Lessor:** Records a finance lease as a receivable at an amount equal to the net investment in the lease.

12.8.2 Presentation

- i) **Lessee:** Presents lease assets and liabilities separately on the statement of financial position, with lease assets depreciated over the lease term or the asset's useful life, whichever is shorter.

- ii) **Lessor:** Presents assets held for operating leases according to their nature, with lease income recognised over the lease term.

12.8.3 Disclosure

The objective of IFRS 16's disclosures is for information to be provided in the notes that, together with information provided in the statement of financial position, statement of profit or loss and statement of cash flows, gives a basis for users to assess the effect that leases have. Paragraphs 52 to 60 of IFRS 16 set out detailed requirements for lessees to meet this objective and paragraphs 90 to 97 set out the detailed requirements for lessors.

- i. **Lessee:** Discloses information about lease assets, liabilities, and expenses, including the measurement policy applied to leases.
- ii. **Lessor:** Discloses information about lease income, assets held for operating leases, and lease receivables.

12.8.4 Recognition exemptions

Instead of applying the recognition requirements of IFRS 16 described above, a lessee may elect to account for lease payments as an expense on a straight-line basis over the lease term or another systematic basis for the following two types of leases:

- i) leases with a lease term of 12 months or less and containing no purchase options – this election is made by class of underlying asset; and
- ii) leases where the underlying asset has a low value when new (such as personal computers or small items of office furniture) – this election can be made on a lease-by-lease basis.

12.8.5 Compliance and impact

Compliance with IFRS 16 is crucial for credible financial reporting and corporate disclosure practices in Nigeria. The new standard has implications for financial ratios, such as leverage and returns on assets, and may affect lessors' business models.

12.9 Treatment of COVID-19-related rent concessions

The International Accounting Standards Board (IASB) issued amendments to IFRS 16 Leases in May 2020 to address COVID-19-related rent concessions. The pronouncement amended IFRS 16 Leases to provide lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification. On issuance, the practical expedient was limited to rent concessions for which any reduction in lease payments affects only payments originally due on or before June 30, 2021.

To qualify for the practical expedient, the rent concession must meet the following conditions:

- a) the change in lease payments results in revised consideration that's substantially the same as or less than the original consideration;
- b) the reduction in lease payments affects only payments due on or before June 30, 2021; and
- c) there's no substantive change to other terms and conditions of the lease.

A lessee may elect not to assess whether a COVID-19-related rent concession is a lease modification. A lessee that applies the exemption accounts for COVID-19-related rent concessions as if they were not lease modifications.

12.10 Interest rate benchmark reform- Phase 2

The Interest Rate Benchmark Reform Phase 2, also known as IBOR reform, addresses changes in the basis for determining contractual cash flows of financial assets, financial liabilities, and lease liabilities. This reform is crucial in Nigeria, as it affects various financial instruments and contracts that reference interest rate benchmarks like the Nigerian Interbank Offered Rate (NIBOR).

A lessee accounts for modifications required by the Interbank Offered Rate (IBOR) reform (modifications required as a direct consequence of the IBOR reform and made on an economically equivalent basis) by updating the effective interest rate. All other modifications are accounted for using the applicable requirements.

12.10.1 Key aspects of Phase 2 reforms

- a) **Changes in Contractual Cash Flows:** The reform provides guidance on how to account for changes in the basis for determining contractual cash flows of financial assets and financial liabilities.
- b) **Practical expedients:** The International Financial Reporting Standards (IFRS) 16 amendments offer practical expedients for lessees and lessors to account for lease modifications resulting from IBOR reform.
- c) **Hedge accounting:** The reform also addresses the impact on hedge accounting, ensuring that changes in interest rate benchmarks do not result in the discontinuation of hedge relationships.
- d) **Financial assets and liabilities:** The reform affects the accounting treatment for financial assets and liabilities that reference interest rate benchmarks.
- e) **Lease liabilities:** The reform also impacts lease liabilities, requiring entities to account for changes in lease payments resulting from IBOR reform.

12.10.2 Implications for Nigerian Entities

- a) **Contractual changes:** Nigerian entities will need to review and potentially modify contracts that reference interest rate benchmarks.
- b) **Financial reporting:** Entities will need to apply the amended accounting standards, ensuring compliance with regulatory requirements.
- c) **Risk management:** Entities should assess the impact of IBOR reform on their risk management strategies and hedge accounting relationships.

12.11 Lessor's forgiveness of lease payments

12.11.1 The IFRS interpretations committee consideration

The IFRS Interpretations Committee (the Committee) considered how a lessor applies IFRS 9 and IFRS 16 in accounting for a particular rent concession. The rent concession in question is one in which the only change to the lease contract is the lessor's forgiveness of lease payments due from the lessee under that contract.

In the case considered, the rent concession changes the original terms and conditions of a lease contract classified by the lessor applying IFRS 16 as an operating lease. The lessor legally releases the lessee from its obligation to make specifically identified lease payments. No other changes are made to the lease contract, nor are there any other negotiations between the lessor and the lessee that might affect the accounting for the rent concession. Before the date the rent concession is granted, the lessor applies the expected credit loss model in IFRS 9 to the operating lease receivable.

A lessor's forgiveness of lease payments can have implications for both the lessor and the lessee from the following aspects:

- a) the lessor can apply the impairment requirements in IFRS 9 to the operating lease receivable. The lessor estimates expected credit losses on the operating lease receivable by measuring any credit loss to reflect 'all cash shortfalls, but before the rent concession is granted, the lessor would measure expected credit losses on the operating lease receivable by following IFRS 9:5, which would include the lessor considering its expectations of forgiving lease payments recognised as part of that receivable; and
- b) the lessor legally releases the lessee from its obligation to make specifically identified lease payments, some of which the lessor has recognised as an operating lease receivable. Therefore, on the date the rent concession is granted, the lessor remeasures expected credit losses on the operating lease receivable (and recognises any change to the expected credit loss allowance in profit or loss) and derecognises the operating lease receivable (and associated expected credit loss allowance).

Accounting treatment

Lessee: When a lessor forgives lease payments, the lessee may recognise the forgiveness as a gain in profit or loss. The gain would be measured as the amount of lease payments forgiven.

Lessor: The lessor would recognise the forgiveness as a loss in profit or loss, measured as the amount of lease payments forgiven.

Tax Implications

Lessee: The forgiveness of lease payments may have tax implications for the lessee. The lessee should consult with a tax professional to determine the tax treatment of the forgiveness.

Lessor: The lessor may be able to claim a tax deduction for the loss recognised due to the forgiveness of lease payments.

The amendment to IFRS 16, issued in September 2022, provides guidance on measuring lease liability in sale and leaseback transactions. How it impacts Nigerian entities are as follows:

- a) **Lease liability measurement:** Seller-lessees determine the lease liability by considering only the lease payments and not the sale proceeds. This ensures accurate measurement of lease liabilities arising from sale and leaseback transactions;
- b) **Variable lease payments:** The amendment may significantly affect subsequent measurement of lease liabilities with variable lease payments;
- c) **Effective date:** The amendment applies to annual reporting periods beginning on or after January 1, 2024, with earlier application permitted; and
- d) **Regulatory requirements:** Financial Reporting Council of Nigeria (FRC) regulates financial reporting in Nigeria and may provide guidance on the accounting treatment for lease payment forgiveness. Nigerian companies may follow International Financial Reporting Standards (IFRS), which provides guidance on accounting for lease modifications, including forgiveness of lease payments and accounting for lease liabilities in sale and leaseback transactions.

The following regulatory requirements should be adhered to by lease entities:

- i) they should understand the new requirements for measuring lease liabilities and recognise the impact on their financial statements;
- ii) they should ensure compliance with regulatory requirements and accounting standards when accounting for lease payment forgiveness;
- iii) they should consider the tax implications of lease payment forgiveness and plan accordingly; and
- iv) they should also review contractual agreements to determine the terms and conditions of lease payment forgiveness.

12.12 Lease term and useful life of leasehold improvements

- a) **Lease term:** The lease term is the non-cancellable period of a lease, plus any periods covered by an option to extend the lease if it's reasonably certain to be exercised. For cancellable or renewable leases, the lease term would include the initial non-cancellable period and any subsequent periods if the lessee has the option to extend and is reasonably certain to exercise that option.
- b) **Useful life of leasehold improvements:** The useful life of leasehold improvements is typically the shorter of the useful life of the improvements that is the period over which the improvements are expected to be used and the remaining lease term that is the period from the date the improvements are made until the end of the lease term.

When determining the lease term and useful life of leasehold improvements, the following factors should be considered:

- a) **Contractual terms:** Review the lease agreement to understand the terms and conditions, including any options to extend or terminate the lease.
- b) **Economic incentives:** Consider the economic incentives for the lessee to exercise options to extend the lease.
- c) **Asset usage:** Determine how the lessee will use the underlying asset and the leasehold improvements.

12.13 Lease liability in a sale and leaseback (IFRS 16 amended)

A sale and leaseback is a transaction in which the owner of an asset sells the asset and leases that asset back from the buyer for a period. The seller-lessee must determine if the transaction qualifies as a sale for which a gain (or loss) is recognised, or if the transaction is treated as a collateralised borrowing.

When originally issued, IFRS 16 included no specific subsequent measurement requirements for sale and leaseback transactions. Consequently, it was not always clear how to subsequently measure the liability arising from a leaseback, particularly where the payments for the lease include payments that do not meet the definition of 'lease payments' in IFRS 16, for example, where the payments include variable lease payments that do not depend on an index or a rate. As a result, in September 2022, the IASB issued Lease Liability in a Sale and Leaseback, which amends IFRS 16 to address the issue of subsequent measurement of the lease liability.

If an asset transfer satisfies IFRS 15's requirements to be accounted for as a sale the seller measures the right-of-use asset at the proportion of the previous carrying amount that relates to the right of use retained. Accordingly, the seller only recognises the amount of gain or loss that relates to the rights transferred to the buyer. If the fair value of the sale consideration does not equal the asset's fair value, or if the lease payments are not market rates, the sales proceeds are adjusted to fair value, either by accounting for prepayments or additional financing. A seller-lessee subsequently measures lease liabilities arising from a leaseback in a way that it does not recognise any amount of the gain or loss that relates to the right of use it retains.

The International Accounting Standards Board (IASB) issued amendments to IFRS 16 in September 2022, clarifying how seller-lessees account for sale and leaseback transactions. The key points are as follows:

- a) **lease liability measurement:** The amendment adds subsequent measurement requirements for sale and leaseback transactions, specifying how to determine the lease liability after the transaction.
- b) **accounting treatment:** Seller-lessees must account for the lease liability based on the lease payments and not the sale proceeds, ensuring accurate measurement.
- c) **effective date:** The amendment applies to annual reporting periods beginning on or after January 1, 2024, with earlier application permitted.

These amendments aim to provide clarity and consistency in accounting for sale and leaseback transactions, helping entities accurately reflect their financial positions. By

specifying how to measure lease liabilities in these transactions, the amendments support transparency and comparability in financial reporting.

Measurement

The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. Variable lease payments that depend on an index or a rate are included in the initial measurement of the lease liability and are initially measured using the index or rate as at the commencement date. Amounts expected to be payable by the lessee under residual value guarantees are also included.

Variable lease payments that are not included in the measurement of the lease liability are recognised in profit or loss in the period in which the event or condition that triggers payment occurs, unless the costs are included in the carrying amount of another asset under another Standard.

The lease liability is subsequently re-measured to reflect changes in:

- a) the lease term (using a revised discount rate);
- b) the assessment of a purchase option (using a revised discount rate);
- c) the amounts expected to be payable under residual value guarantees (using an unchanged discount rate); or
- d) future lease payments resulting from a change in an index or a rate used to determine those payments (using an unchanged discount rate).

The re-measurements are treated as adjustments to the right-of-use asset. Lease modifications may also prompt re-measurement of the lease liability unless they are to be treated as separate leases.

The answer to the following questions will be a guide to proper measurement, presentation, disclosure and determination of transition and effective date to sale and leaseback transactions:

- a) how does a seller-lessee determine the proportion of the right-of-use asset retained at the sale and leaseback transaction date?
- b) how does a seller-lessee determine the lease liability at the sale and leaseback transaction date?
- c) how does a seller-lessee subsequently measure the right-of-use asset and lease liability in a sale and leaseback transaction?
- d) does an entity have to estimate expected variable lease payments?
- e) how does the seller-lessee account for a partial or full termination of the leaseback?
- f) how does the seller-lessee measure 'revised lease payments' for the leaseback under the amendments, on a re-measurement/modification date?

Presentation and disclosure

- a) How is the lease liability presented in the statement of financial position?

- b) Are additional disclosures required in the financial statements?

Transition and effective date

- a) When are the amendments effective?
- b) How are the amendments applied generally?
- c) How are the amendments applied where an entity applied IFRS 16 in its first set of IFRS financial statements?
- d) Should an entity present a third statement of financial position when adopting the amendments?

Accounting treatment

The accounting for sale and leaseback transactions under IFRS 16, 'Leases', depends on whether the transfer of the asset qualifies as a sale in accordance with IFRS 15, 'Revenue from contracts with customers'. A sale and leaseback qualifies as a sale if the buyer-lessor obtains control of the underlying asset. Where the transfer of the asset qualifies as a sale, the seller-lessee also recognises the leaseback by recognizing a lease liability, reflecting the payment terms of the leaseback and a right-of-use asset for the right of use retained.

The gain or loss that the seller-lessee recognises at the date of the transaction is a consequence of its measurement of the right-of-use asset arising from the leaseback. Because the right of use that the seller-lessee retains is not remeasured as a result of the transaction (it is measured as a proportion of the property, plant and equipment's previous carrying amount), the amount of the gain or loss recognised relates only to the rights transferred to the buyer-lessor. Applying paragraph 53(i) of IFRS 16, the seller-lessee discloses gains or losses arising from sale and leaseback transactions.

IFRS 16 requires a seller-lessee to account for a right-of-use asset arising from a sale and leaseback in this manner to reflect that, from an economic standpoint, the seller-lessee has sold only its interest in the value of the underlying asset at the end of the leaseback – it has retained its right to use the asset for the duration of the leaseback. The seller-lessee had already obtained that right to use the asset at the time when it purchased the asset, since the right of use is an embedded part of the rights that an entity obtains when it purchases, for example, an item of PP&E. Recognizing only the amount of the gain or loss that relates to the rights transferred to the buyer-lessor – and thus not recognising the amount of the gain or loss that relates to the rights retained by the seller-lessee – appropriately reflects the economics of a sale and leaseback transaction.

12.14 Chapter review

In this chapter, the treatments for the various classifications of leases have been covered with regards to its tax implications. Finance and operating leases were properly discussed taken IFRS 16 and other relevant tax laws into consideration.

12.15 Worked examples

12.15.1 Questions

- 1(a). FFF Limited leased manufacturing equipment from GGG Leasing Limited. The total lease sum is N15,000,000; but the fair market value is N10,000,000. The equipment has an economic life of 5 years, The lease term is 4 years with an option to buy the equipment lease for N100,000 by the lessee. The lease is not cancellable, and the lessee is responsible for maintenance, insurance and upkeep of the equipment.

Required:

Explain with supporting reasons the type of lease as described by the above statement.

- (b) MAN Haulage Company Limited leased a truck from Auto Motors Limited. The cost of the truck is N15,000,000 and monthly lease payment is N300,000 payable at the beginning of each month. The lessor is responsible for repairs, maintenance and registration of the vehicle while the lessee takes care of fuelling, lubrication, tyres replacements. The expected useful life of the truck is 10 years. The lease term is 2 years in the first instance, and it is renewable subject to agreement by the two parties; either party can also opt out of the arrangement after 3 months' notice.

Required:

Explain with supporting reasons the type of lease as described by the above statement.

2. Discuss the practical steps to be followed so as to effectively manage tax impacts of a leased asset.
3. An entity (seller-lessee) sells a building to another entity (buyer-lessor) for cash of N18,000,000 (the fair value of the building at the date of sale). Immediately before the transaction, the building was carried at a cost of N10,000,000. At the same time, the seller-lessee enters into a contract with the buyer-lessor for the right to use the building for an initial period of five years and the economic useful life of the building is 20 years.

Lease payments (which are at market rates), payable annually, comprise fixed payments and variable payments that do not depend on an index or a rate. The terms and conditions of the transaction are such that the transfer of the building by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the building. Accordingly, the seller-lessee accounts for the transaction as a sale and leaseback.

Required:

- (a) Determine the proportion of the right of use retained.
- (b) Ascertain the present value of the expected residual value of the asset at the end of the leaseback.
- (c) Compute the gain on rights transferred.

4. XYZ Nigeria Limited is a manufacturing company which has incurred an assessable loss of ~~N~~18,000,000 at the end of the financial year December 31, 2023. In addition to the above, the company has leased out some under-utilised factory machinery. The net profit made from this leasing business is ~~N~~4,000,000.

On June 2, 2023, XYZ sold one of its buildings which had been acquired in January, 2023 at a cost of ~~N~~500,000,000 for ~~N~~560,000,000 to ABC Ltd. On the same day, XYZ leased back the building under the following terms:

- (i) On finance lease terms for 3 years non-cancellable.
- (ii) the lease rental is ~~N~~20,000,000 (inclusive of interest) payable December 31, each year.
- (iii) Interest payments of ~~N~~4,500,000 ~~N~~4,000,000 and ~~N~~3,000,000 are to be made by XYZ for the years 2023, 2024 and 2025 respectively.
- (iv) The lessee has the option to purchase the building for ~~N~~650,000,000 at the expiration of the lease term.

Required:

- (a) Compute the tax payable and the loss carried forward by XYZ Nigeria Limited for the year ended December 31, 2023.
 - (b) Compute the withholding tax to be deducted by the lessee from the total lease rental due to the lessor for years 2023 – 2025.
 - (c) Determine the VAT expected to be charged by the lessor on the transaction he made with the lessee.
 - (d) Explain if the lessee is entitled to claim input tax paid.
 - (e) Determine the capital gains tax due from the lessor if the lessee exercises the option of purchasing the building on the expiration of the lease term.
 - (f) Explain if the lessee is liable to capital gains tax in this circumstance.
 - (g) Explain if the lessor is entitled to claim capital allowance and if yes, explain the basis for this.
 - (h) Explain if the lessee is entitled to claim capital allowances and if yes, explain the basis for this.
5. Discuss the:
- (a) Tax implications for a lessor in a finance lease.
 - (b) Tax implications for a lessee in a finance lease.
 - (c) Tax implications for a lessor in an operating lease.
 - (d) Tax implications for a lessee in an operating lease

6. Differentiate between finance lease and operating lease in a tabular form.

12.15.2 Solutions to questions

- 1(a) In accordance with the provisions of SAS 11 and IFRS 16, this is a **finance lease**. This is so because the lease is not cancellable, the lease term is 80% of the useful life of the assets, the lease agreement contains a purchase option, and the lessor would have recovered substantial part of his investment and possibly made a reasonable return thereof.
- (b) According to the provisions of SAS 11 and IFRS 16, this is an **operating lease**. The lease has a cancellable provision. The lessee can only be sure of using the asset for 2 years out of the expected life span of 10 years. The lessor takes responsibility for day-to-day upkeep and maintenance of the truck and furthermore, the lease does not provide for any purchase option.
2. The practical steps to effectively manage tax impacts of a leased asset are as follows:
- a) **Identify all leases:** Pull together a comprehensive lease inventory. This should include obvious long-term real estate leases and any equipment or vehicle leases that run beyond 12 months.
 - b) **Review and classify for tax purposes:** Distinguish leases that qualify as true (operating) leases from those that count as non-tax (or finance) leases. This classification dictates whether the lease produces rental deductions or depreciation and interest.
 - c) **Implement a tracking system:** Investing in lease management software can streamline how you capture key data points from initial entries to ongoing payments and automatically generate reconciliations between book and tax treatments.
 - d) **Monitor and reconcile book-to-tax differences:** Maintain detailed schedules for changes in right-of-use assets, lease liabilities, deferred rent eliminations, and interest expense permutations. These schedules will feed into deferred tax calculations and assist in year-end (or interim) reviews.
 - e) **Stay Current with Rules:** Tax law is fluid. Keep an eye on potential Federal or State changes that could alter how various leases are treated. Also, remain alert to international standard changes if you have global footprints under IFRS 16.

- 3 (a) Applying paragraph 100(a) of IFRS 16, the seller-lessee is required to determine the proportion of the building transferred to the buyer-lessor that relates to the right of use that it retains. Paragraph 100(a) does not prescribe a particular method for determining that proportion. The seller-lessee could determine this proportion by comparing, for example, the present value of expected payments for the lease (including those that are variable) with the fair value of the building at the date of the transaction.

Assume that the seller-lessee estimates the expected payments over the lease term, and it discounts those expected payments using the incremental borrowing rate (since the rate implicit in the lease cannot be readily determined), resulting in a present value of the expected payments for the lease of ₦4,500,000.

In this example, the proportion of the building that relates to the right of use retained is 25%, calculated as ₦4,500,000 (that is, the present value of expected payments for the lease) divided by ₦18,000,000 (that is, the fair value of the building).

- (b) The present value of the expected residual value of the asset at the end of the leaseback is ₦13,500,000 and the fair value of the asset at the date of the transaction is ₦18,000,000, the value of the rights retained by the seller-lessee is ₦4,500,000 (₦18,000,000 – ₦13,500,000), and the proportion of the building that relates to the right of use retained is 25%, calculated as ₦4,500,000 divided by ₦18,000,000.

- (c) The gain on rights transferred is calculated as follows:

Cash	<u>₦18,000,000</u>
Right-of-use asset: (₦10,000,000 × 25%)	₦2,500,000
Building	₦10,000,000
Lease liability	₦4,500,000
Gain on rights transferred: (₦18,000,000 – ₦10,000,000) × 75%	₦6,000,000

4(a)

XYZ Nigeria Limited

Computation of tax payable

For the year ended December 31, 2023

	₦'000
Loss from manufacturing activities	18,000
Profit from leasing activities	4,000

Tax payable (30% of ~~N4,000,000~~)	1,200
Loss carried forward	18,000

Based on the above, XYZ Nigeria Limited is required to disclose the profit from each line of business and separately subject the profit of **N4,000,000** which arose from the leasing business to tax. The loss of **N18,000,000** will be available to be carried forward for relief in subsequent years.

(b) Computation of WHT to be deducted by Lessee (XYZ)

	2023	2024	2025
	N'000	N'000	N'000
Interest	4,500	4,000	3,000
WHT @ 10%	450	400	300

(Note: Under a finance lease arrangement, withholding tax (WHT) is computed on only the interest portion of the lease rental)

(c) Determination of VAT chargeable by lessor (ABC Ltd)

This is a finance lease. The lease rental receivable by the lessor is a return on investment; VAT is therefore not applicable.

(d) Whether lessee is entitled to claim input Tax

The lessee is not expected to claim input tax. He is expected to have capitalized the any VAT paid on acquisition of the asset with the actual cost of the assets.

(e) The capital gains tax liability of the Lessor:

10% of (N650,000,000 – N560,000,000) = N9,000,000

(f) The lessee's Capital Gains Tax Liability is:

10% x (N560,000,000 – N500,000,000) = N6,000,000

(g) This is a finance lease arrangement. The lessor is not entitled to claim capital allowances.

(h) It is the lessee that has the right to claim capital allowances under a finance lease arrangement.

5 (a) The tax implications for a lessor in a finance lease are as follows:

- (i) **Interest portion:** The interest portion of the rental earned by the lessor is taxable income.
- (ii) **Capital portion:** The capital portion is a repayment of the initial investment and has no tax implication.
- (iii) **Withholding tax (WHT):** Computed only on the interest portion of the total lease payment due from the lessee, at 10%.
- (iv) **Value added tax (VAT):** Not imposed on interest earned by the lessor.
- (v) **Capital gains tax (CGT):** Imposed on any capital gains realised if an asset is disposed of at the expiration of the lease period.

(b) The tax implications for a lessee in a finance lease are as follows:

- i) **Interest portion:** The interest portion of the periodic lease rental and other related expenses are deductible for income tax purposes.
- ii) **Capital allowance:** The lessee is entitled to claim capital allowance on the capital portion of the value of the leased assets.
- iii) **Withholding tax (WHT):** Withheld by the lessee at 10% on the interest portion of the lease rental and remitted to the Federal Inland Revenue Service (FIRS).
- iv) **Value added tax (VAT):** Input tax on the purchase of the asset can be capitalized with the cost of the asset.

(c) The tax implications for a lessor in an operating lease are as follows:

- i) **Total lease rental:** The total lease rental received or receivable by the lessor is income and wholly taxable.
- ii) **Capital allowance:** The lessor is entitled to claim capital allowance on the leased assets.
- iii) **Withholding tax (WHT):** Computed on the total lease rental, at 10%.
- iv) **Value added tax (VAT):** Imposed on the lease rental income, at 7.5%.

(d) The tax implications for a lessee in an operating lease

- i. **Rental charges:** Allowable deductions for tax purposes.
- ii. **Withholding tax (WHT):** Withheld by the lessee at 10% of the rental payment and remitted to the FIRS.
- iii. **Value added tax (VAT):** Charged by the lessor on the lease rental is not an input tax to the lessee.

6. Differentiation between finance lease and operating lease

S/N	Finance lease	Operating lease
1	It is non-cancellable	The lease may be cancelled or renewed as may become necessary.
2	Lease term covers substantially (80% or more) of the useful life of the asset, or net present value of the lease at inception.	Lease term does not cover a significant useful life of the asset, or net present value of the lease at inception.
3	The ownership risks and rewards are transferred to the lessee.	The risk and ownership of the asset remains with the lessor.
4	The lessee is under obligation to pay such cost as insurance,	The lessor is under obligation to pay such cost as insurance,

	maintenance and similar charges on the asset.	maintenance and similar charges on the asset.
5	The lessee is entitled to claim capital allowances of the leased asset. The lessor is not entitled to claim capital allowances.	The lessee is not entitled to claim capital allowances. The lessor is entitled to claim capital allowances of the leased asset.
6	The interest expense in the income statement is not tax deductible.	The interest expense in the income statement is tax deductible.
7	The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than fair value at the date of exercising the option.	The lessee does not have the option to purchase the asset.
8	The lease is for a long period of time than in an operating lease.	The lease is for a shorter period of time than in a finance lease.

NON-RESIDENT TAXATION

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13 Non-resident Taxation

13.0 Learning objective

The learning objective of this chapter is to enhance readers' understanding of non-resident taxation in Nigeria.

13.1 Learning outcomes

On successful completion of 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.

13.2 Chargeability to tax – resident individuals

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.

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.

13.2.1 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.

13.2.2 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 brought 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 evidence that such salary has not been subjected to tax outside Nigeria, the tax shall be payable in Nigeria.

13.3 Resident and non-resident companies

13.3.1 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 resident in UK if it is managed and controlled in UK. This is known as international dual residence.

13.3.2 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 its 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.

13.4 Dual residence

An individual or company may have dual or multiple residence status.

13.4.1 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.

13.4.2 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.

13.4.3 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 (for example, the USA), citizens are 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 based on 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.

13.5 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.

13.6 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".

13.7 Comparison of overseas branch with overseas subsidiary

13.7.1 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 commonwealth.

13.7.2 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.

13.8 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 to produce 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.

13.9 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 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 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.

13.9.1 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.

13.9.2 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”.

13.9.3 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 “offshore” profits but taxed wholly in Nigeria.

13.9.4 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 circumstances, 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.

13.9.5 “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.

13.9.6 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.

13.10 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:

- (a) withholding tax shall be the final tax for technical, management, consultancy or professional fees earned by non-resident companies;
- (b) 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
- (c) non-resident companies are to file corporate tax returns with the Federal Inland Revenue Service.

13.11 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.

13.12 Worked examples

13.12.1 Questions

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.

Required:

Explain the status of the branch for tax purposes.

2. Taxation is a world-wide concept that cuts across all the nations of the world. For meaningful progress to be made, a nation is expected to trade with others to earn the needed fund for development. Such activities are usually conducted by individuals and companies.

A group of foreign investors is interested in investing in Nigeria, having noted with passion a submission made by a researcher on the investment opportunities

available in your country. Specifically, they desire preliminary information on non-resident individuals liable to Nigerian income tax and classification of resident and non-resident companies.

Your line manager requested for your input on the matters at stake to assist him to finalise discussion with the foreign investors.

Required:

Advise your manager on the relevant salient points required.

3. Robertson Andersen Incorporated of New Jersey, USA has R&A Nigeria Limited as its subsidiary in Nigeria. In 2023, the Federal Government of Nigeria awarded a contract to the foreign company for the construction of an Export Processing Zone located in the Southeast of Nigeria for the sum of \$1.2 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 Limited at ₦178 million at Bomil.
- (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 ₦900 per \$1

Required:

Compute the tax payable by the company for the relevant tax year.

4. The Companies Income Tax Act CAP C21 LFN 2004 (as amended), identifies 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:

- (a) the fixed base test;
- (b) the agency test; and
- (c) the turnkey contract test.

Required:

Explain the key tests stated above in the taxation of non-residents.

5. (a) To what extent are non-resident individuals liable to Nigerian income tax?
- (b) Use the following figures for 2024 tax year to illustrate your answer and state how Mr. Tobi Babatolu's 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

13.12.2 Suggested solutions to questions

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.
2. 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.

- (a) **Resident company:** A company is deemed to be resident in Nigeria if it is incorporated or registered in Nigeria.
- (b) **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.

3

Robertson Andersen Incorporated
Computation of tax payable
For 2024 assessment year

	₦	₦
Turnover (\$1.2 million x ₦900)		1,080,000,000
Deduct:		
Materials and other inputs	334,957,750	
Hire of dredger	<u>178,000,000</u>	<u>(512,957,750)</u>
		567,042,250
Personnel costs	157,689,250	
Cost of foreign experts	120,500,000	
Other administrative costs	<u>115,546,750</u>	<u>(393,736,000)</u>
Assessable profit		174,221,250
Capital allowance	74,221,750	
C/A relieved	<u>(74,221,750)</u>	<u>(74,221,750)</u>
	NIL	
Total profit		<u>99,999,500</u>
Tax payable @ 30% of total profit		<u>29,999,850</u>
Tertiary education tax @ 3% of assessable profit		<u>5,226,637.5</u>

4. The key tests in the taxation of non-residents

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
- (i) 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 arm's 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:

- (i) 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; and
- (ii) 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.

- 5 (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.

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 government. The incomes include temporary guest, lecturer, teacher, nurse, doctor, dividend, rent, interest, incomes of a sportsman, author, playwright, musician, etc.

(b)

Mr. Tobi Babatolu
Computation of income tax payable
for 2024 year of assessment

	₦
Earned income	
Directors' fees	3,000,000
Unearned income	
Dividends (Gross ~~₦~~ 650,000 x 100/90)	<u>722,222</u>
Total income	3,722,222
Less: Relief	
Consolidated allowance ~~₦~~ 200,000 + 20% of ~~₦~~ 3,000,000	<u>(800,000)</u>
Chargeable income	2,922,222
Less: Dividend treated as franked investment income	<u>(722,222)</u>
Taxable income	<u>2,200,000</u>
Apply tax table	
First ~~₦~~ 300,000 @ 7%	21,000
Next ~~₦~~ 300,000 @ 11%	33,000
Next ~~₦~~ 500,000 @ 15%	75,000
Next ~~₦~~ 500,000 @ 19%	95,000
Balance of ~~₦~~ 600,000 @ 21%	<u>126,000</u>
	<u>350,000</u>

Tutorial notes

- (i) A non-resident individual is only entitled to consolidated allowance.
- (ii) Foreign earnings are not liable to Nigerian income tax.
- (iii) Dividend is treated as franked investment income and therefore, exempted from tax.

ICAN 2025

TAXATION OF DIGITAL ECONOMY

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14 Taxation of Digital Economy

14.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the basic concepts and application of taxation of the digital economy in Nigeria.

14.1 Learning outcomes

On successful completion of 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) evaluate measures put in place by other countries to tackle the problem associated with taxing digital economy;
- (f) ascertain what could be done in Nigeria to block tax revenue leakages associated with digital economy

14.2 Concept of digital economy

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:

- (a) digitalisation and intensive use of information and communication technologies (ICT);
- (b) codification of knowledge;
- (c) transformation of information into commodities; and
- (d) new ways of organising work and production.

14.3 Taxation of 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 implementation of the cashless policy with one of its aims being to encourage more electronic-based transactions (payments for goods, services, transfers, etc.).

Taxation of digital transactions has become a herculean task 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. Taxation of digital economy are characterised by the following features:

- (a) 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;
- (b) profits derived from foreign jurisdictions might end up not being taxed in the jurisdiction of the consumer where money was parted with;
- (c) it is usually challenging to determine whether tax on cross border transactions should be paid to the jurisdiction where value is created or consumed;
- (d) Nigeria seems not to have made significant progress in the taxation of digital transactions although myriads of digitalised transactions are carried on a daily bases in Nigeria;
- (e) the Nigerian tax authorities are working towards ensuring digitalization of the tax collection process; and
- (f) the digitalisation has not been extended to cover effective monitoring and collection of taxes from digital transactions.

Pursuant to section 6(1)(c) and (d) of the Capital Gains Tax Act 2004 (as amended), disposal of digital assets for capital gains tax purposes occurs where any capital sum is derived from a sale, lease, transfer, assignment, compulsory acquisition, or other disposition of such digital assets,

While definitions regarding the scope of 'digital assets' are divergent, there appears to be some consensus on the point that 'digital assets' include (but are not limited to) cryptocurrencies, and non-fungible Tokens ("NFTs").

The Companies Income Tax (Significant Economic Presence) Order, 2020 Order provided clarifications on the definition of the following terms referenced in Section 13(2)(c) and (e) of CITA 2004 (as amended):

- (a) "any other electronic or wireless apparatus" is defined to include digital or related activities carried on through satellite; and
- (b) "services of a technical nature" means specialised services, such as advertising, training or provision of personnel other than those involved in the provision of professional, management and consultancy services.

14.4 Challenges of taxing digital goods and services and ways of mitigating against them

14.4.1 Challenges of taxing digital goods and services

From the provisions of the CGTA and the Act, the disposal of digital assets situated within or outside Nigeria by a taxable person in the country attracts 10% CGT. The challenges are enumerated below:

- (a) the ambiguity of what constitutes “digital assets” for CGT assessment purposes because, neither the CGTA nor the Act defines digital assets. Hence, a key practical challenge associated with the taxation of digital assets in Nigeria is the determination of what constitutes ‘digital assets’ for tax purposes;
- (b) challenges due to digital cross-border nature and the difficulty in determining the appropriate jurisdiction for taxation purposes. This has created loopholes that are exploited by digital businesses, leading to concerns about tax evasion and profit shifting;
- (c) the difficulty associated with the fair market valuation of digital assets for tax purposes, this is because the worth of most digital assets is derived from the context in which they are used, rather than from an independent free market value;
- (d) valuation of a digital asset is central to the computation of the tax payable upon its disposal, this attributed to the question how chargeable gains on digital assets should be calculated in terms of deduction of expenses and other statutory allowances for tax purposes;
- (e) taxpayers and relevant tax authorities alike may expect to have very sharp disputes arising from these issues in the implementation of digital assets taxation in Nigeria;
- (f) the difficulty encountered by the relevant tax authorities in tracking digital asset transactions for tax compliance and enforcement purposes giving the current restrictions put in place on cryptocurrencies by the Central Bank of Nigeria (“CBN”);
- (g) the existence of the various profitable business models in digital services that derive income from countries without creating palpable physical presence;
- (h) the inability of the tax authority to adequately capture the quantum of attendant direct and indirect taxes payable on e-commerce transaction has left leakages in the tax system;
- (i) the failure of the applicable rules for corporate taxation to effectively capture the realities of a modern economy in our world of fast-paced digital transactions;
- (j) the application of section 13 of the Companies Income Tax Act (CITA) which stipulates 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;
- (k) non-resident companies are taxed in Nigeria based on profits derived from Nigeria, raising the controversial question as to whether a foreign company is liable to pay income tax in Nigeria;

- (l) some 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; and
- (m) the non-compliance of the FIRS requirement on the Nigerian companies to withhold tax on all payments made to non-resident persons regardless of the non-establishment of the tax presence given that such non-resident persons may not be liable to Nigerian tax under Nigerian tax laws.

14.4.2 Ways of mitigating against the challenges

- (a) The Federal Inland Revenue Service (FIRS) is making efforts to ensure that income arising from e-commerce is subjected to Nigerian tax. These efforts should be enhanced to yield positive results in the aspect of direct taxes as it is already yielding in the aspect of indirect taxes.
- (b) The FIRS should 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.
- (c) There should be a strategic partnership between Federal Inland Revenue Services (FIRS) with institutions that provide platforms to consummate digital transactions to ensure that the objective of minimising and reducing tax leakages from the digital economy is achieved at a faster pace.
- (d) The FIRS should require Nigerian companies to withhold tax on all payments made to non-resident persons regardless of the non-establishment of the tax presence so as to ensure that companies, particularly digital companies, do not escape tax in Nigeria.
- (e) The FIRS should ensure that VAT is deducted and accounted for on cross border payments for transactions between foreign companies and Nigerian companies in reliance on the Federal High Court (FHC) judgment in the case between Vodacom Business Nigeria Limited v FIRS, where 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.

14.5 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 digitalised 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.

14.6 Existing legal/administrative framework for taxing digital transactions taking into consideration the provisions of the relevant Finance Acts

The Finance Act 2019 introduced an amendment to the Companies Income Tax Act to impose tax on a foreign entity with respect to certain services or digital transactions if it has a Significant Economic Presence (SEP) in Nigeria. It further provides that the Finance Minister may by order, determine what constitutes SEP in Nigeria.

Prior to the entry into force of Finance Act 2019, non-resident companies (NRCs) were only deemed to be liable to tax in Nigeria on their business income if they:

- (a) carried on business through a fixed base in Nigeria;
- (b) carried on business through an agent in Nigeria;
- (c) executed a turnkey project in Nigeria; or
- (d) failed to price their related party transactions at arm's length.

Finance Act 2019 expanded the conditions under which the business income of NRCs would be taxable in Nigeria. Under the new rules, NRCs will be liable to tax in Nigeria if:

- (a) they supply digital services or goods and profits can be attributable to the activities; or they provide TMPC services; and
- (b) they have a significant economic presence (SEP) in Nigeria.

Consequently, the Federal Government of Nigeria has 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, commenced on February 3, 2020.

The Order provides guidance on the definition of significant economic presence (SEP) in relation to taxable income derived by any company other than a Nigerian company ("foreign company") in Nigeria, based on Section 13(2)(c) and (e) of CITA.

The Order also stipulates a N25 million turnover threshold for a foreign company deriving income in Nigeria through digital means for the purpose of SEP. Further, foreign companies involved in the provision of technical, professional, management or consultancy services shall be deemed to have SEP in Nigeria where such companies receive any payment from a person resident in Nigeria or a fixed base or agent of a foreign company in Nigeria.

The issuance of the Order signals the operationalisation of the provisions of Section 13(2)(c) and (e) of the CITA introduced by the Finance Act, 2019.

The summarised features of the SEP Order are as follows:

- (a) Nigeria has joined other countries that have taken unilateral action to tax the digital economy;
- (b) it has made it clear that a physical presence will no longer be required for certain categories of remote services to be taxable;
- (c) non- resident companies must therefore assess how the rules affect them and take steps to comply where necessary;
- (d) the Nigerian resident companies that transact with the affected non-residents must assess how the rules affect them and take steps to comply where necessary;
- (e) in order to improve compliance and reduce uncertainty for taxpayers, the FIRS is encouraged to introduce simplified registration and compliance processes for affected NRCs; and
- (f) the basis by which profits will be attributed to the SEPs of the NRCs should be clearly provided by FIRS.

Section 2(4) of the Capital Gains Tax Act 2004 requires taxpayers who have disposed a digital asset to, not later than 30 June and 31 December of the relevant year, compute the applicable capital gains tax (CGT), file self- assessment CGT returns, and pay the computed CGT to the relevant tax authority in Nigeria.

The Finance Act 2023 was signed into law on May 28, 2023, but took effect on September 1, 2023. Amongst other things, the Act expands the definition of “chargeable assets” under the Capital Gains Tax Act 2004 (as amended) to include “digital assets”. This effectively imposes a capital gains tax (“CGT”) of 10% on the disposal of “digital assets” in Nigeria. Given the unconventionality of these digital assets in Nigeria, and the fact that the country is still a developing digital economy, there are legitimate concerns regarding the feasibility of digital assets taxation in the country. It goes without saying that the legal and regulatory position regarding the taxation of digital assets in Nigeria is not yet settled.

Section 2(4) of the Capital Gains Tax Act 2004 (as amended) requires taxpayers who have disposed a digital asset to, not later than 30 June and 31 December of the relevant year, compute the applicable CGT, file self-assessment CGT returns, and pay the computed CGT to the relevant tax authority in Nigeria.

Digital assets are now considered to be chargeable assets under the Capital Gains Tax Act, thereby making them liable to capital gains tax upon disposal. The term “digital asset” is, however, not defined. Considering the broad spectrum of digital assets, the absence of a definition for the term “digital assets” creates uncertainty for taxpayers. It will be interesting to see how the tax authorities will implement these provisions, particularly in relation to digital assets such as cryptocurrencies which the CBN prohibited its regulated financial institutions from either dealing in them or facilitating its trade or exchange

14.6.1 Digital transactions

A foreign entity involved in digital transactions will be deemed to have created an SEP in Nigeria and therefore liable to tax if it:

- (a) derives income of N25m or equivalent in other currencies from Nigeria in a year;
- (b) uses Nigerian domain name (.ng) or registers a website address in Nigeria; and
- (c) has a purposeful and sustained interactions with persons in Nigeria by customising its digital platform to target persons in Nigeria for example, by stating the prices of its products or services in Naira.

14.6.2 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 customising 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.

14.6.3 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.

14.6.4 Exemptions 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 digitalisation 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 Global trends in digital taxation

The BEPS Action 1 work has evolved over the last 5 years into what is now known as Pillars 1 and 2. While Pillar 1 focuses on the allocation of taxing rights, Pillar 2 deals with global anti-base erosion mechanism (global minimum tax). It is expected that BEPS Action 1 will be finalised by the end of this year when a consensus approach will be agreed upon among the over 130 countries (including Nigeria) involved in the negotiations.

One of the main challenges discussed under Pillar 1 work programme is the administration of taxing right. The work programme recommended developing a collection mechanism for withholding tax, new reporting obligations and information dissemination to the tax authorities, and modalities for addressing technical and practical issues that may arise in determining and reporting the location of sales.

However, there is no clear provision in the Order that addresses any of these issues as it affects the implementation of SEP in Nigeria. It is unclear how the Order is to be administered particularly as self-assessment may not be the appropriate means of efficient administration for businesses not used to or not aware of tax obligations in Nigeria.

It is remarkable that the Federal Government has taken unilateral action to address the taxation of the digital economy in its quest for widening its tax net. Paragraph 3 of the Order has also evinced the intention of the Government that this is an interim measure which will be overridden by a consensus approach to taxation of the digital economy at the end of the current round of OECD negotiations. Before then, it is hoped that the FIRS will issue an information circular that will clarify some of the issues highlighted above.

14.8 Tackling the challenges associated with taxation of digital economy: other jurisdiction experience

14.8.1 OECD recommended proposals

The Organisation of Economic Cooperation and Development (OECD) have offered certain recommendations to address incidences of non-taxation of income arising from digital transactions. These include:

- (a) the introduction of a digital service tax (DST) and the concept of a virtual permanent establishment (VPE) to help determine the incidence of permanent establishment for tax purposes;
- (b) the OECD's interim report on the implications of digitalisation 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;
- (c) 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 each jurisdiction. However, there are presently divergent views amongst the OECD member countries on the issue; and
- (d) 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.

14.8.2 EU recommended proposals

The European Union (EU) have offered certain recommendations to address incidences of non-taxation of income arising from digital transactions. These include:

- (a) 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;
- (b) 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.
- (c) the DST will be collected by the Member Countries where the users are located and will only apply to companies that have 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;

- (d) 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 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:
 - (i) it exceeds a threshold of £7 million in annual revenues from a member state; or
 - (ii) it has more than 100,000 users in a member state in a taxable year; or
 - (iii) over 3000 business contracts for digital services are created between the company and business users in a member state in a taxable year.
- (d) 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.

14.8.3 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.

14.8.4 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; or
- (c) this concept of “significant economic presence” became effective from April 2019 with the enactment of Finance Act 2019.

14.9 Tackling the challenges associated with taxation of 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:

(a) 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.

(b) 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.

(c) 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.

(d) 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.

(e) 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 minimising and reducing tax leakages especially from the digital economy is achieved at a faster pace.

(f) 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.

(g) 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.

14.10 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 jurisdictions. 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 foreign entity carrying on business of digital and other services in Nigeria in line with the provision of Finance Act, 2019.

14.11 Worked examples

14.11.1 Questions

1. The Organisation of Economic Cooperation and Development (OECD) offered certain recommendations to address incidences of non-taxation of income arising from digital transactions.

Required:

Discuss the challenges associated with taxing digital economy in Nigeria.

2. The Federal Government of Nigeria has 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, commenced on February 3, 2020.
The Order provides guidance on the definition of significant economic presence (SEP) in relation to taxable income derived by any company other than a Nigerian company ("foreign company") in Nigeria, based on Section 13(2)(c) and (e) of CITA.

Required:

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

3. The Order issued by the Minister of Finance provides guidance on the definition of significant economic presence (SEP) in relation to taxable income derived by any company other than a Nigerian company ("foreign company") in Nigeria, in line with Section 13(2)(c) and (e) of CITA.

Required

Explain the features of this Order.

4. The rapid growth in information and communication technology in Nigeria has brought with it boundless opportunities and changes in the way business activities are done. A significant number of transactions in Nigeria, in recent times, are consummated using mobile devices and online payments. In the same vein, the online platforms (mostly operated by international private entities), are perceived by various governments in developing countries (Nigeria inclusive) as means of undermining the economic interest of their host countries through non-payment of taxes in spite of their significant economic presence.

In the light of the above, the Finance Act 2019 provides for the treatment of digital and other services' providers in relation to significant economic presence of a foreign entity. This was also followed up with the issuance of Companies Income Tax (Significant Economic Presence) Order 2020 by the Federal Government of Nigeria.

You have been contacted by a foreign online outfit with interest in mobile networking and consultancy, Washishi Incorporation, California, USA, through its official partner in Nigeria Abioro Partners, to explain issues on significant economic presence of a foreign entity, deemed to be operating in Nigeria.

Required:

As a tax consultant to Washishi Incorporation, you are to draft a report explaining the underlisted areas:

- (a) The objectives of the relevant provisions of Finance Act 2019 and Companies Income Tax (Significant Economic Presence) Order 2020 in respect to significant economic presence of a foreign entity
- (b) Conditions for the determination of significant economic presence for digital activities
- (c) Determination of significant economic presence for technical and consultancy services
- (d) Activities exempted from significant economic presence in Nigeria
- (e) The tax implications of the Order 2020 on activities of Washishi Incorporation

14.11.2 Suggested solutions to questions

1. 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 optimisation) 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 e-commerce 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 minimising 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 2004 implies that a non-resident company must have physically performed activities in Nigeria before it can be concluded that such a company is liable to income tax 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. Moreso, 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.

The 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.

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 their automated means..."

(a) 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:

- (i) derives ~~N~~25 million annual gross turnover or its equivalent in other currencies from any or combination of the following digital activities:

- 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
 - 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
 - provision of goods or services other than those under subparagraph 5 of the Order, directly or indirectly through a digital platform to Nigeria; or
 - provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers in Nigeria.
- (ii) Uses a Nigerian domain name (i.e., .ng) or registers a website address in Nigeria; or
- (iii) Has a purposeful and sustained interaction with persons in Nigeria by customising 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.

(b) 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.

3. The Order provides guidance on the definition of significant economic presence (SEP) in relation to taxable income derived by any company other than a Nigerian company ("foreign company") in Nigeria, based on Section 13(2)(c) and (e) of CITA.

The Order also stipulates a ₦25 million turnover threshold for a foreign company deriving income in Nigeria through digital means for the purpose of SEP. Further, foreign companies involved in the provision of technical, professional, management or consultancy services shall be deemed to have SEP in Nigeria where such companies receive any payment from a person resident in Nigeria or a fixed base or agent of a foreign company in Nigeria. The issuance of the Order is significant to the operation of the provisions of Section 13(2)(c) and (e) of the CITA introduced by the Finance Act, 2019.

The summarised features of the SEP Order are as follows:

- (a) Nigeria has joined other countries that have taken unilateral action to tax the digital economy.
- (b) it has made it clear that a physical presence will no longer be required for certain categories of remote services to be taxable.
- (c) non-resident companies must therefore assess how the rules affect them and take steps to comply where necessary.
- (d) the Nigerian resident companies that transact with the affected non-residents must assess how the rules affect them and take steps to comply where necessary.
- (e) to improve compliance and reduce uncertainty for taxpayers, the FIRS is encouraged to introduce simplified registration and compliance processes for affected NRCs.
- (f) the basis by which profits will be attributed to the SEPs of the NRCs should be clearly provided by FIRS.

4.

Okokomako Tax Consultants
Kokobilo Road, Asaba City

July 20, 2024

Washishi Incorporation
California
USA.

Attention: The Principal Partner

Abioro Partners
Sabon-Yewa Avenue
Kaduna

Dear Sir,

RE: Significant Economic Presence of a Foreign Entity

We refer to our discussion on July 16, 2024, in respect of the above subject matter and our subsequent engagement as a tax consultant to Washishi Incorporation, USA. Having concluded the assignment, we are pleased to present our report for further necessary action by the management of Washishi Incorporation.

(a) The objectives of the provisions of Finance Act 2019 and Companies Income Tax (Significant Economic Presence) Order 2020

- (i) The Finance Act 2019 introduced the concept of significant economic presence 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.
- (ii) Consequently, the Companies Income Tax (Significant Economic Presence) Order 2020 was issued by the Federal Government of Nigeria.
- (iii) The Order provides clarification on what constitutes a significant economic presence for foreign companies doing business, or providing services to customers in Nigeria, in line with section 13(2)(c) and (e) of Companies Income Tax Act 2004 (as amended).

(b) Conditions for determination of significant economic presence for digital activities

The Order provides that a foreign company shall have a significant economic presence in Nigeria in any accounting year, where it:

- (i) derives ₦25million annual gross turnover or its equivalent in other currencies from any or combination of the following digital activities:
- (ii) 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
- (iii) 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
- (iv) 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
- (v) provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers in Nigeria; or
- (vi) uses a Nigerian domain name (that is, .ng) or registers a website address in Nigeria; or
- (vii) has a purposeful and sustained interaction with persons in Nigeria by customising 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.

(c) Determination of significant economic presence for technical and consultancy services

The Order provides that a foreign company providing technical, professional, management or consultancy services shall have a significant economic presence in Nigeria in any accounting year where:

- (i) it earns any income; or
- (ii) receives any payment from a person resident in Nigeria; or
- (iii) it has a fixed base or agent of a foreign company in Nigeria.

(d) Activities exempted from significant economic presence in Nigeria

The Order exempts the activities of the following foreign companies from constituting a significant economic presence in Nigeria:

- (i) any foreign company under a multilateral agreement and consensus arrangement to address tax challenges arising from the digitalisation of the economy who will be treated under such agreement or arrangement; or
- (ii) any foreign company making any payment, where the payment, is made:
 - to an employee under a contract of employment; or
 - for teaching in an educational institution or for teaching by an educational institution; or
 - by a foreign fixed base of a Nigerian company.

(e) The tax implications of the Order 2020 on the activities of Washishi Incorporation

- (i) The current status of Washishi Incorporation is within the ambit of the Order 2020. The implication is that profit derived by the company from Nigerian operation will be assessable to tax in Nigeria.
- (ii) Maintenance of proper books of accounts that will be relevant for assessment of the company to Nigerian taxes.
- (iii) For the company to enjoy from numerous tax available to companies incorporated in Nigeria, the company should have a fixed base or better still be fully incorporated as a Nigerian company.
- (iv) Failure by the company to comply with the Order 2020 may result to severe sanctions from the Nigerian government. This can cause disruption in operations of the company within the Nigerian space.

We have commented on areas deemed necessary, nevertheless, please do not hesitate to contact us if there is any aspect of the report that needs further clarification.

Yours faithfully,
For: OKOKOMAKO TAX CONSULTANTS

O. SADAM
Senior Partner

TAX TREATIES

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15 Tax Treaties

15.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the basic concepts and operations of tax treaties in Nigeria.

15.1 Learning outcomes

On successful completion of 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;
- (f) understand the conflicts resolution between DTA's and the Nigerian tax laws; and
- (g) understand the role of Vienna convention in applying and interpreting tax treaties.

15.2 Unilateral reliefs

This is the relief granted to mitigate the effects of international double taxation based on 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 exists 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.

15.3 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.

Double taxation is a process where the same income is taxed in two different jurisdictions. This often occurs when a taxpayer is required to pay tax on the same income in the country where it is earned and again in their country of residence. To mitigate this financial burden, Nigeria has established Double Taxation Relief (DTR) mechanisms through laws, treaties, and agreements with other nations.

- a) Nigeria has signed double taxation agreements (DTAs) with multiple countries to regulate the taxation of income derived from residents of either country.
- b) These agreements provide tax credits, exemptions, or reduced rates of tax.
- c) The relief is reciprocal, meaning both countries agree to tax specific types of income in a way that prevents double taxation.

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.

15.3.1 Double taxation agreement with United Kingdom

After the termination of all double taxation agreements between foreign countries and Nigeria, one of the earliest agreements 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 (Article 6);
- (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 (Article 8);
- (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 to 7.5%;

- (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 (Article 11);
- (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 (Article 12);
- (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 (Article 13);
- (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 a fixed 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 (Article 14);
- (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 (Article 17); and
- (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 (Article 22).

15.3.2 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.

15.4 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 organisations.

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.

15.5 Tax treaty and double taxation relief

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, but 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.

15.6 Commonwealth income tax relief

15.5.1 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 December 31, 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.

15.6.2 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 Commonwealth 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 of 30%; and
- (b) for the second company, 5% that is the difference between the Nigerian rate (30%) and half of the Commonwealth rate ($50\% \times \frac{1}{2} = 25\%$) – 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.

It is pertinent to 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.

15.6.3 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 46 of 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;
- (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; and
- (i) a taxpayer may not be granted treaty benefits if:
 - i. it is discovered that its residency of one of the treaty countries was principally for the purpose of accessing the treaty benefits; and
 - ii. a principal purpose of the arrangement of a transaction or business is to take advantage of the treaty.

15.7 Benefits of double taxation agreement

Double taxation relief plays a vital role in the international taxation system, ensuring that individuals and businesses are not burdened by paying taxes on the same income or gains twice. Understanding the mechanism, types, and advantages of double taxation relief empowers individuals and businesses to optimise their financial resources while ensuring compliance with relevant tax laws.

Double taxation relief offers several benefits to individuals, businesses, and the Nigerian economy, including:

- a) **encourages foreign investment:** Investors are more willing to invest in Nigeria, knowing that they will not be taxed twice on their income;
- b) **prevents tax evasion:** DTAs establish clear guidelines on which country has the right to tax certain incomes, reducing tax evasion and disputes;

- c) **promotes economic growth:** Businesses can operate across borders without the burden of excessive taxation, leading to increased trade and economic development;
- d) **enhances international relations:** Bilateral and multilateral tax agreements strengthen Nigeria's diplomatic and economic ties with other countries;
- e) avoidance of double taxation;
- f) clarification of taxing rights of each contracting state; and
- g) lowering of compliance cost.

15.8 Resolution of conflicts between double taxation agreements (DTA) and Nigerian tax laws

Where a resident of a contracting state considers that the action of one or both 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, then:

- (a) 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;
- (b) 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; and
- (c) 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.

15.9 Dispute resolution mechanism

It is hardly possible to ignore the effect of double taxation in the era of globalisation. 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 recognised dispute resolution mechanisms are:

a) **The mutual agreement procedure (MAP)**

This is a kind of negotiation between the two contracting States. 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 “endeavour 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 have 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.

b) 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.

15.10 Nigerian double taxation agreements (DTA)

15.10.1 Permanent establishment (PE)

This means 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:

- a) facilities such as a factory, an office, a branch, a mine or an oil well;
- b) activities such as building, construction, assembly or installation; and
- c) 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:

- a) Facilities used solely for storage or display of goods or merchandise;
- b) 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:

- a) if the business is through a dependent agent, the profit attributable to that agent;
- b) if the business involves turnkey projects, the profit from that contract; and
- c) if the business is through related parties, the profit determined on arms length principle by the relevant tax authority.

15.10.2 Active double taxation agreement

The FIRS circular highlights that Nigeria has operational DTAs with 16 countries namely: Canada, Pakistan, Belgium, France, Romania, Netherlands, United Kingdom, China, South Africa, Italy (airline and shipping only), Philippines, Czech Republic, Slovakia, Singapore, Sweden and Spain.

Tabular presentation of list of countries having double taxation agreement with Nigeria:

S/N	Countries	DTA type	Date of entry into force	Effective date
1	Canada	Full DTA	Nov 16, 1999	Jan 1, 2000
2	Pakistan	Full DTA	Mar 7, 1990	Jan 1, 1991
3	Belgium	Full DTA	Jan 1, 1990	Jan 1, 1991
4	France	Full DTA	May 2, 1991	Jan 1, 1992
5	Romania	Full DTA	Apr 18, 1993	Jan 1, 1994
6	Netherlands	Full DTA	Dec 9, 1992	Jan 1, 1993
7	United Kingdom	Full DTA	Jan 1, 1988	Jan 1, 1989
8	China	Full DTA	Mar 21, 2009	Jan 1, 2010
9	South Africa	Full DTA	Jul 5, 2008	Jan 1, 2009
10	Italy	Air & Shipping Transport Agreement Only	February 22, 1977	Jan 1, 1978
11	Philippines	Full DTA	Aug 18, 2013	Jan 1, 2014
12	Czech Republic	Full DTA	Dec 2, 1990	Jan 1, 1991
13	Slovakia	Full DTA	Dec 2, 1990	Jan 1, 1991
14	Sweden	Full DTA	December 7, 2014	January 1, 2015
15	Spain	Full DTA	June 5, 2015	January 1, 2016
16	Singapore	Full DTA	November 1, 2018	January 1, 2019

15.10.3 Date of entry into force of the DTA

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 DTAs states 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".

15.10.4 Effective date or date of application of the agreement

Both 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 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.

15.10.5 Taxation of business profits and income from immovable properties

a) Business profits

- (i) 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.
- (ii) 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.
- (iii) 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.
- (iv) 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.
- (v) 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.

- (vi) 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%.

b) 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.

15.10.6 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:
 - 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; and
 - 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 7 or 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 “secured by mortgage and whether 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

15.11 The role of Vienna Convention in application and interpretation of tax treaties

The Vienna Convention plays the following roles in the application and interpretation of tax treaties:

- (a) it codifies the rules of treaty interpretation, including tax treaties with its objective to bind the judiciary through a set of rules, it generated a uniform approach to treaty interpretation;
- (b) it establishes comprehensive, operational guidelines, rules, and procedures for how treaties are drafted, defined, amended, and interpreted;
- (c) it establishes that every treaty in force is binding upon the parties to it and must be performed by them in good faith such that a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty;
- (d) it provides a framework for interpreting and applying tax treaties, promoting consistency and predictability in international taxation; and
- (e) It follows the Vienna Convention on the Law of Treaties (VCLT’s) principles in ensuring that tax treaties are applied fairly and in accordance with their intended purpose.

The Vienna Convention on the Law of Treaties (VCLT) plays a significant role in the application and interpretation of tax treaties. Some of the roles are stated below:

Interpretation of tax treaties

- a) **General rule:** The VCLT provides general rules for interpreting treaties, including tax treaties. Article 31(1) states that treaties should be interpreted in good faith, in accordance with the ordinary meaning of the terms, and in the context of the treaty.
- b) **Context and purpose:** The VCLT emphasizes considering the context and purpose of the treaty when interpreting its provisions.

Application of tax treaties

- a) **Binding nature:** The VCLT confirms that treaties are binding on the parties that have ratified them. Tax treaties, therefore, are binding on the contracting states.
- b) **Good faith:** The principle of good faith is essential in the application of tax treaties. States should act in a manner that is consistent with the treaty's purpose and provisions.

Dispute resolution

- a) **Interpretation disputes:** The VCLT provides mechanisms for resolving disputes related to treaty interpretation, including negotiation, mediation, and arbitration.
- b) **Mutual Agreement Procedure (MAP):** Tax treaties often include MAP provisions, which allow competent authorities to resolve disputes through mutual agreement.

15.12 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 and the significant role played by Vienna Convention in the application and interpretation of tax treaties.

15.13 Worked examples

15.13.1 Questions

1. Sadiku Mustapha & Co. Limited is a firm of medical practitioners with a clinic in Lagos. In 2023, the operations of the company were extended to a neighbouring commonwealth country. The results of its business operations for the year ended

December 31, 2023, for both domestic and foreign transactions as follows:

	Kano Clinic	Foreign Clinic	Total
	₦	₦	₦
Fees	3,000,000	10,000,000	13,000,000
Sales of drugs	<u>1,700,000</u>	<u>5,000,000</u>	<u>6,700,000</u>
	<u>4,700,000</u>	<u>15,000,000</u>	<u>19,700,000</u>
Less: Expenses			
Staff salaries	1,840,000	3,000,000	4,840,000
Electricity and rates	30,000	500,000	500,000
Motor vehicle maintenance	90,000	110,000	200,000
Depreciation of asset	290,000	500,000	790,000
Purchase of drugs	900,000	1,000,000	1,900,000
Bank charges and interest	100,000	34,000	134,000
Foreign taxes suffered	-	3,020,000	3,020,000
Miscellaneous expenses	<u>300,000</u>	<u>500,000</u>	<u>800,000</u>
Total expenses	<u>3,550,000</u>	<u>8,664,000</u>	<u>12,214,000</u>
Profit	<u>1,150,000</u>	<u>6,336,000</u>	<u>7,486,000</u>

Additional information:

- (a) The capital allowance of ₦2,900,000 was agreed with the Federal Inland Revenue Service.
- (b) The company is a wholly Nigerian company.

Required:

Compute the Income tax liability of Sadiku Mustapha & Co. Limited for the relevant year of assessment, stating clearly the double tax relief applicable to the company.

2. A double taxation arrangement (DTA) is a bilateral agreement between two countries designed to prevent individuals and businesses from being taxed twice on the same income. These treaties promote cross-border trade and investment by clarifying tax obligations, reducing tax barriers, and providing mechanisms for resolving disputes. DTAs typically allocate taxing rights between the contracting states and offer relief through tax exemptions, credits, or reduced rates, ensuring fair and efficient taxation for taxpayers operating internationally.

Required:

Discuss the tax implications 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

3. AD International Limited runs a pharmacy practice in Nigeria and Ghana. The company's operating results for the year ended December 31, 2024, are as follows:

	₦
Income from Nigeria	50,000,000
Income from Ghana	<u>22,000,000</u>
Total Income	72,000,000
Less Overheads	<u>(40,000,000)</u>
Net profit	<u>32,000,000</u>

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.

4. Datto Nigeria Limited is a Nigerian company, which commenced business in January 2010. The company paid income tax of \$900 and \$2,520 in Belgium on its taxable profits of \$3,600 and \$7,200 for 2021 and 2022 assessment years, respectively, with respect to its branch, which qualifies as a permanent establishment in Belgium.

The total profits of the company in Nigeria in those respective assessment years, based on its worldwide income, are N7.2 million and N9.6 million. The tax rate in Nigeria is 30%, while Belgium imposes tax at the rate of 25% for income below \$4,000 and 35% for \$4,000 income and above. Nigeria and Belgium have a double

taxation agreement, with Article 23 of the Agreement providing for credit method of elimination of double taxation.

Required:

Compute the tax payable in Nigeria by the company for the relevant years of assessment in line with Section 46 of CITA. (Assume exchange rate of N1,000 to \$1 in both years).

15.13.2 Suggested solutions to questions

1.

Sadiku Mustapha & Co. Ltd.

Computation of adjusted profit

For 2024 assessment year

	N	N
Net profit as per accounts		7486,000
Add back:		
Depreciation of assets	790,000	
Foreign tax suffered	<u>3,020,000</u>	<u>3,810,000</u>
Assessable profit		11,296,000
Capital allowance	2,900,000	
C/A relieved	<u>(2,900,000)</u>	<u>(2,900,000)</u>
	—	
Total profit		<u><u>8,396,000</u></u>
Income tax @ 30%		2,518,800
Less: double tax relief (15% of N8,020,556)		<u>(1,203,083)</u>
Final tax liability		<u><u>1,315,717</u></u>

Computation of adjusted profit for foreign business

	N	N
Net profit per foreign accounts		6,336,000
Add back:		
Depreciation	500,000	
Foreign tax	<u>3,020,000</u>	<u>3,520,000</u>
Adjusted profit		9,856,000
Deduct capital allowance		<u>(1,835,444)</u>
Total profit		<u><u>8,020,556</u></u>

Commonwealth rate of tax	=	$\frac{3,020,000}{8,020,556}$
	=	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 = $\frac{290,000}{790,000} \times 2,900,000$	=	1,064,556
Foreign Clinic = $\frac{500,000}{790,000} \times 2,900,000$	=	1,835,444

2. Tax implications of the following:

- 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).
- 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 (Article 8).
- 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 (Article 11).
- 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 (Article 10).
- 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).

3.

AD International Limited

2023 income tax computations

Basis period: 01/01/22 – 31/12/22

	₦	₦
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	<u>4,200,000</u>	<u>9,700,000</u>
Assessable profit		41,700,000
Deduct:		
Capital allowance – Nigeria	3,540,000	
Capital allowance – Ghana	<u>1,450,000</u>	
(Maximum of 662/3% of N41,700,000)		<u>(4,990,000)</u>
Total profit		36,710,000
Income tax at 30%		11,013,000
Less: double taxation relief (15% of N8,650,000)		<u>(1,297,500)</u>
Final tax liability		<u>9,715,500</u>
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	<u>4,200,000</u>	<u>4,950,000</u>
Assessable profit		10,100,000
Less: capital allowances		<u>(1,450,000)</u>
Total profit		<u>8,650,000</u>

$$\text{Commonwealth rate of tax} = \frac{4,200,000}{8,650,000} \times 100\% = 48.55\%$$

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.

4. The tax payable in Nigeria is computed thus:

For 2021 year of assessment:

Tax rate on the income in Belgium = 25%

Nigeria's rate of tax = 30%

Tax paid in Belgium = \$900 (i.e. \$3,600 X 0.25)

Total profit (based on the worldwide income) ₦7,200

Tax payable in Nigeria:

Tax computed (₦7,200,000 X 0.3) = ₦2,160,000

Less double taxation relief: (\$900 X ₦1,000) = 900,000

Tax payable = 1,260,000

The rate of tax on the income in Belgium is on net basis and lower than the Nigerian rate of tax, full credit relief will be granted.

For 2022 year of assessment:

Tax rate on the income in Belgium = 35%

Nigeria's rate of tax = 30%

Tax payable in Belgium = \$2,520 (i.e. \$7,200 X 0.35)

Tax payable in Nigeria:

Total profit (based on the worldwide income) ₦9,600,000 ₦

Nigeria's rate of tax = 30%

Tax computed (₦9,600,000 X 0.3) = 2,880,000

Less double taxation relief: *(\$7,200,000 X 0.3 X ₦1,000) = 2,160,000

Tax payable = 720,000

Although the rate of tax on the income is on net basis, it is higher than the rate of tax in Nigeria. As such, the maximum credit that may be given in Nigeria is restricted to the amount which is equivalent to that produced using the Nigerian rate of tax on the foreign income.

TRANSFER PRICING

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16 Transfer Pricing

16.0 Learning objective

The objective of this chapter is to enhance readers' understanding of matters relating to the transfer pricing methodology and related items in Nigeria

16.1 Learning outcomes

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.

16.2 Introduction to transfer pricing

16.2.1 Transfer price/pricing

Transfer price is the price charged for goods or services supplied or transferred by one sub-unit of an organisation to another sub-units 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:

- a) tangible goods (raw materials, spare parts, finished goods, etc);
- b) services (marketing, legal, accounting, insurance, management services, training, etc); and
- c) intangibles (trademarks, patents, copyright, etc).

16.2.2 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) Act 2011);
- c) Section 15 of the Petroleum Profits Tax Act CAP P13 LFN 2004 (as amended by the Petroleum Profits Tax (Amendment) Act 2007
- d) Section 61 of the Federal Inland Revenue (Establishment) Act 2007; and
- e) The Income Tax (Transfer Pricing) Regulation Act of 2018.

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.

16.2.3 The significance of transfer pricing

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.

16.2.4 Tax convention models on transfer pricing

Advice on transfer pricing based on Organisation 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:

- a) provide countries with the tools they need to fight artificial shifting of profits out of their jurisdiction by multinational enterprises ("MNEs");
- b) provide MNEs with some certainty of treatment in the country concerned;
- c) reduce the risk of economic double taxation;
- d) provide a level playing field between countries, which is less likely to distort the pattern of international trade and investment; and
- e) provide a level playing field between MNEs and independent enterprises doing business within a country

16.2.5 Advice on transfer pricing based on United Nations (UN) guidelines

The UN Model Tax Convention Article 9(1) states that, where:

- i) 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
- ii) 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.

16.2.6 Advice on transfer pricing base on Pacific Association of Tax Administrator (PATA)

Pacific Association of Tax Administrator (PATA) members which include Australia, Canada, Japan and the United States have endeavoured 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.

16.3 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. 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 favourable investment climate and take into consideration investor confidence.

16.4 Administrative framework and procedures for conducting transfer pricing

In Nigeria, the administrative framework and procedures for conducting transfer pricing are established by the Federal Inland Revenue Service (FIRS) and are guided by the following:

16.4.1 Laws and regulations

- a) Transfer Pricing Regulations, 2018: Issued by the FIRS, these regulations provide the framework for transfer pricing in Nigeria;
- b) The Companies Income Tax Act (CITA), 2004: This Act provides the legal basis for transfer pricing in Nigeria;
- c) The Federal Inland Revenue Service (FIRS) Act, 2007: This Act establishes the FIRS as the tax authority responsible for administering transfer pricing regulations in Nigeria.

16.4.2 Administrative framework for conducting transfer pricing

- a) **The Federal Inland Revenue Service (FIRS):** The FIRS is responsible for administering transfer pricing regulations in Nigeria.
- b) **The Transfer Pricing Unit:** The FIRS has a dedicated Transfer Pricing Unit responsible for reviewing transfer pricing documentation and conducting audits.
- c) **The tax Tribunals:** Tax tribunals are established to hear appeals against FIRS decisions on transfer pricing matters.

16.4.3 Procedures for conducting transfer pricing

- a) Filing of transfer pricing returns: Taxpayers are required to file transfer pricing returns with the FIRS, providing information on related party transactions;
- b) Submission of transfer pricing documentation: Taxpayers are required to submit transfer pricing documentation to the FIRS, providing detailed information on related-party transactions and transfer pricing methodologies;
- c) Audit and examination: The FIRS conducts audits and examinations to review transfer pricing documentation and ensure compliance with transfer pricing regulations; and
- d) Adjustments and penalties: The FIRS may adjust transfer prices and impose

penalties for non-compliance with transfer pricing regulations.

16.4.4 Guidelines and circulars

- a) The FIRS Transfer Pricing Guidelines: The FIRS issues guidelines to provide clarity on transfer pricing regulations and procedures;
- b) The Circulars and Public Notices: The FIRS issues circulars and public notices to provide updates on transfer pricing regulations and procedures.

16.5 Benchmarking databases and technology in the transfer pricing analysis

Benchmarking databases and technology play a crucial role in transfer pricing analysis, enabling companies to determine arm's length prices for controlled transactions.

- a) **Benchmarking databases provide access to financial and operational data from various sources, including:**
 - i publicly traded companies: Financial statements, annual reports, and other publicly available data;
 - ii. private companies: Data from private companies, often obtained through surveys or contributions from participating companies; and
 - iii. industry reports: Reports from market research firms, industry associations, and other organisations.

Some popular benchmarking databases include:

- i Royalty source: Provides royalty rate data for intellectual property transactions;
- ii. Bloomberg BNA: Offers a range of transfer pricing databases, including the Royalty Rate Database and the Transfer Pricing Database;
- iii. Thomson Reuters: Provides access to various benchmarking databases, including the Transfer Pricing Database and the Royalty Rate Database; and
- iv. KPMG's Transfer Pricing Database: A comprehensive database of financial and operational data for benchmarking purposes.

b) Technology used in benchmarking

Advanced technologies are used to analyse and process large datasets, enabling efficient and accurate benchmarking:

- i. Data analytics software: Tools like Excel, Python, R, and SQL are used for data manipulation, analysis, and visualisation.
- ii. Machine learning algorithms: Techniques like regression analysis, clustering, and decision trees are applied to identify patterns and relationships in the data.

- iii. Data visualisation tools: Software like Tableau, Power BI, or D3.js helps to create interactive and dynamic visualizations of the data.
- iv. Cloud-based platforms: Cloud-based solutions, such as Amazon Web Services (AWS) or Microsoft Azure, provide scalable infrastructure for data storage, processing, and analysis.

c) Benefits of benchmarking databases and technology

The use of benchmarking databases and technology in transfer pricing analysis offers several benefits:

- i. improved accuracy: Access to comprehensive and reliable data enables more accurate benchmarking and transfer pricing analysis;
- ii. increased efficiency: Automation and advanced analytics streamline the benchmarking process, reducing the time and resources required;
- iii. enhanced transparency: The use of benchmarking databases and technology provides a clear and transparent framework for transfer pricing analysis;
- iv. better risk management: By leveraging benchmarking data and technology, companies can proactively identify and mitigate transfer pricing risks.

By leveraging benchmarking databases and technology, companies can ensure more accurate and efficient transfer pricing analysis, reducing the risk of non-compliance and potential disputes with tax authorities.

16.6 Nigerian Transfer Pricing Regulations

16.6.1 Objectives

The objectives of the Regulations are to:

- a. ensure that Nigeria can 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;
- b. provide the Nigerian authorities with the tools to fight tax evasion through over or under pricing of controlled transactions between related persons;
- c. reduce the risk of economic double taxation;
- d. provide a level playing field for both multinational enterprises and independent enterprises carrying on business in Nigeria; and
- e. provide taxable persons with certainty of transfer pricing treatment in Nigeria.

16.6.2 Scope

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:

- a) sale and purchase of goods and services;
- b) sales, purchase or lease of tangible assets;
- c) transfer, purchase, licence or use of intangible assets;
- d) provision of services;
- e) lending or borrowing of money;
- f) manufacturing arrangements; and
- g) 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.

The 2018 regulations also 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) Act 2007);
- ii. section 17 of the Personal Income Tax Act, CAP P8, Laws of the Federation of Nigeria, 2004 (as amended by the Personal Income Tax (Amendment) Act 2011);
- 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; and
- v. Value Added Tax Act, CAP, V1, Laws of the Federation of Nigeria, 2004.

16.6.3 Commencement date

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 regard to transfer pricing and control transaction, as well as treatment of transactions of permanent establishment (PE) and dispute resolution.

16.6.4 Connected taxable persons

In Nigeria, connected taxable persons are individuals or entities that have a relationship with each other that can affect their transfer pricing. The Nigerian Transfer Pricing Regulations, 2018, defines connected taxable persons as:

- a) Connected persons include:
 - i. **Husband and wife:** A husband and wife are considered connected persons.
 - ii. **Relatives:** Relatives, such as parents, children, siblings, and grandparents, are considered connected persons.
 - iii. **Partners:** Partners in a partnership are considered connected persons.
 - iv. **Trustees and beneficiaries:** Trustees and beneficiaries of a trust are considered

connected persons.

- b) Connected entities include:
 - i) **Subsidiaries:** A subsidiary and its parent company are considered connected entities.
 - ii) **Associated companies:** Companies that are associated with each other through common ownership or control are considered connected entities.
 - iii) **Joint ventures:** Parties to a joint venture are considered connected entities.
 - iv) **Entities under common control:** Entities that are under common control, such as entities controlled by the same individual or group, are considered connected entities.
- c) Other connected persons are:
 - i) **Agents and principals:** An agent and its principal are considered connected persons.
 - ii) **Employees and employers:** An employee and their employer are considered connected persons.
 - iii) **Entities with significant influence:** Entities that have significant influence over each other's financial and operating policies are considered connected entities.

These relationships can impact transfer pricing, and the Nigerian tax authorities may scrutinize transactions between connected taxable persons to ensure that they are conducted at arm's length.

16.6.5 Transfer pricing methods and evaluation of taxpayer's-controlled transactions

Controlled transaction constitutes commercial or financial transaction between connected taxable persons.

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.

The 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.

The transfer pricing methods

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. They are classified into two categories as follows:

- (a) Traditional transaction methods
- (b) The comparable uncontrolled price (CUP) method;
 - The resale price method;
 - The cost plus method;
- (c) Transactional profit methods
 - The transactional net margin method; or

- The transactional profit split method; and

Any other method which may be prescribed by regulations made by the service from time to time.

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.

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.

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.

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.

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 examines the net profits in relation to an appropriate base (for example, costs, sales, assets) and not gross margin on resale or mark-up on costs.

16.6.6 Advance pricing agreements (APA)

- a) 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.
- b) A request for advance pricing agreements shall be accompanied by–
 - i) A description of the activities of the taxable person to be addressed by the advance pricing agreement, including:
 - a detailed description of the controlled transactions to be included within the scope of the advance pricing agreement;
 - an analysis of functions to be performed, assets to be employed and risks to be assumed by the parties to the covered transactions; and
 - the proposed duration of the advance pricing agreement;
 - ii) 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:

- an analysis of the comparability factors;
 - the selection of the most appropriate transfer pricing method to the circumstances of the controlled transactions; and
 - the critical assumptions as to future events under which the determination is proposed;
- iii) The identification of any other country or countries that the person wishes to participate in the advance pricing agreement;
- iv) Any other relevant information that the Service may require to complete its analysis of the advance pricing agreement request.
- c) The Service may accept, modify or reject a request made by a connected person after considering documents/information that accompanied the request and the expected benefits from an advance pricing agreement.
- d) The service may in addition to accept, modify or reject a request may specify the basis for acceptance, modification or rejection of a request.
- e) 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.
- f) 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.
- g) An advance pricing agreement entered under this regulation shall apply to the controlled transactions for a period not exceeding three years.
- h) The Service may terminate an advance pricing agreement by notice where:
- i. the connected person has failed to materially comply with fundamental terms of the Advance pricing agreement;
 - ii. there has been a material breach of one or more of the critical assumptions underlying the advance pricing agreement;
 - iii. there is a change in the tax law that is materially relevant to the Advance pricing agreement; or
 - iv. the advance pricing agreement was entered into based on a misrepresentation, mistake or omission by the connected person.
- i) A connected person may terminate an advance pricing agreement by a notice given to the Service where:
- i. there is a material change in the premise upon which the advance pricing request was made;
 - ii. the advance pricing agreement is no longer relevant based on significant changes to the structure of the controlled transaction; or
 - iii. there is a change in tax law applicable in the jurisdiction of the controlled transaction that is materially relevant to the Advance pricing agreement.
- j) The Service shall treat as confidential any trade secret or other commercially sensitive information or documentation provided to the Service while negotiating or entering into an Advance pricing agreement.

- k) Termination of an advance pricing agreement takes effect, in the case of:
 - i. sub-regulation (8) (a) and (c) of this regulation, from the date specified by the Service in the notice of termination;
 - ii. sub-regulation (8) (b) of this regulation, from the date the material breach occurred;
 - iii. sub-regulation (8) (d) of this regulation, from the date the advance pricing agreement was entered into; and
 - iv. sub-regulation (9) of this regulation, from the date specified in the notice of termination.

16.6.7 Functional analysis in transfer pricing

Functional analysis is a crucial step in the transfer pricing process, particularly when applying the Transactional Net Margin Method (TNMM) or the Comparable Profits Method (CPM).

Functional analysis is a detailed examination of the functions performed, risks assumed, and assets employed by each entity within a multinational enterprise (MNE) group. This analysis helps identify the economic activities, responsibilities, and contributions of each entity involved in controlled transactions.

The objectives of functional analysis are to:

- a) identify functions: Determine the specific functions performed by each entity, such as manufacturing, marketing, distribution, research and development (R&D), and management;
- b) assess risks: Evaluate the types and levels of risks assumed by each entity, including market risks, credit risks, operational risks, and financial risks;
- c) determine assets: Identify the assets employed by each entity, such as tangible assets (for example, property, plant, and equipment), intangible assets (for example, patents, trademarks), and financial assets;
- d) analyse responsibilities: Examine the responsibilities and decision-making authority of each entity, including strategic decisions, operational management, and financial control;

The steps involved in functional analysis are:

- a) **Gather information:** Collect relevant data and documents, such as organisational charts, job descriptions, financial statements, and contracts.
- b) **Identify controlled transactions:** Determine the controlled transactions between entities within the MNE group.
- c) **Analyse functions, risks, and assets:** Examine the functions performed, risks assumed, and assets employed by each entity involved in controlled transactions.
- d) **Evaluate comparability:** Assess the comparability of the functions, risks, and assets of each entity to those of independent companies.

Importance of functional analysis

Functional analysis is essential in transfer pricing as it:

- a) **Ensures accurate pricing:** Helps determine arm's length prices for controlled transactions.
- b) **Supports TNMM and CPM:** Provides critical input for these transfer pricing methods.
- c) **Enhances transparency:** Facilitates understanding of the economic activities and contributions of each entity within the MNE group.
- d) **Reduces risk of disputes:** Helps mitigate potential transfer pricing disputes with tax authorities.

By conducting a thorough functional analysis, MNEs can ensure compliance with transfer pricing regulations, reduce the risk of disputes, and maintain accurate and transparent pricing practices.

16.6.8 Basic comparability factors in the process of benchmarking

- a) In the process of transfer pricing benchmarking, the following basic comparability factors are considered:
 - (i) **Functions**
 - Functions performed by the entities being compared (for example, manufacturing, marketing, distribution);
 - Degree of responsibility and decision-making authority.
 - (ii) **Contractual terms**
 - Terms and conditions of the controlled transaction (for example, payment terms, delivery terms);
 - Level of risk assumed by each party.
 - (iii) **Economic conditions**
 - Market conditions (for example, demand, competition, market size)
 - Economic indicators (for example, GDP, inflation rate, interest rates)
 - (iv) **Property or services**
 - Characteristics of the property or services being transferred (for example, quality, quantity, specifications)
 - Intangibles (for example, patents, trademarks, know-how)

(v) Risks

- Level of risk assumed by each party (for example, market risk, credit risk, operational risk)
- How risks are allocated between the parties

(vi) Industry and market

- Industry characteristics (for example, growth rate, profitability, competitive landscape)
- Market characteristics (for example, market size, demand, competition)

(vii) Geographic location

- Location of the entities being compared (for example, country, region, city)
- Local market conditions and economic indicators

(viii) Business strategies

- Business strategies employed by the entities being compared (for example, cost-plus, market-based, value-based)
- How business strategies impact pricing decisions

(ix) Tax and regulatory environment

- Tax laws and regulations applicable to the entities being compared
- Impact of tax and regulatory environment on pricing decisions

(x) Timing

- Timing of the controlled transaction (for example, date of sale, date of payment)
- How timing impacts pricing decisions

(b) Basic documentation requirements for transfer pricing benchmarking:

(i) Master file

- Overview of the multinational enterprise (MNE) group's business
- Description of the MNE group's organisational structure
- Financial and operational data for the MNE group

(ii) Local file

- Detailed information about the local entity's business operations
- Description of the local entity's functions, risks, and assets
- Financial and operational data for the local entity

(c) Benchmarking study

i) Description of the benchmarking methodology used

- ii) Identification of the comparables used in the study
 - iii) Analysis of the comparables' financial and operational data
 - iv) Conclusion on the arm's length price or range
- (d) Financial statements
 - i) Audited financial statements for the local entity and the MNE group
 - ii) Financial statements for the comparables used in the benchmarking study
- (e) Transfer pricing policy
 - i) Description of the MNE group's transfer pricing policy
 - ii) Explanation of the methodology used to determine arm's length prices
 - iii) documentation of the transfer pricing policy's implementation and review process.
- (f) Inter-company agreements
 - i) Copies of intercompany agreements, such as contracts and memoranda of understanding
 - ii) Description of the terms and conditions of the intercompany agreements
- (g) Country-by-Country Reporting (CbCR)
 - i) Documentation of the MNE group's CbCR, including:
 - ii) Revenue and profit/loss data
 - iii) Number of employees
 - iv) Tangible assets
 - v) Tax paid
- (h) Supporting documentation

Any additional documentation that supports the transfer pricing analysis, such as:

 - (i) market research reports;
 - (ii) industry studies; and
 - (iii) economic analyses

16.7 Dispute resolution mechanisms

- a) Advance pricing agreements (APAs)
 - i) A prior agreement between the taxpayer and the tax authority on the transfer pricing methodology.
 - ii) Can be unilateral (with one tax authority) or multilateral (with multiple tax authorities).
- b) Mutual agreement procedures (MAPs)
 - i) A process for resolving transfer pricing disputes between two or more tax authorities.
 - ii) Aimed at avoiding double taxation and preventing fiscal evasion.
- c) Competent authority (CA) proceedings
 - i) A process for resolving transfer pricing disputes between tax authorities.
 - ii) Involves negotiations between the competent authorities of the countries involved.
- d) Arbitration
 - i) A binding process for resolving transfer pricing disputes.
 - ii) Involves an independent third-party arbitrator or panel.
- e) Mediation
 - i) A non-binding process for resolving transfer pricing disputes.
 - ii) Involves a neutral third-party mediator who facilitates negotiations.
- f) Transfer Pricing Audits and Appeals
 - i) A process for resolving transfer pricing disputes through audits and appeals.
 - ii) Involves a review of the taxpayer's transfer pricing documentation and policies.
- g) International Arbitration Courts
 - i) Specialised courts that resolve international tax disputes, including transfer pricing disputes.

- ii) Examples include the International Chamber of Commerce (ICC) and the London Court of International Arbitration (LCIA).
- h) Bilateral Advance Pricing Agreements (BAPAs)
 - i) A prior agreement between the taxpayer and two or more tax authorities on the transfer pricing methodology.
 - ii) Aimed at providing certainty and avoiding disputes.

Dispute resolution under the Nigerian Transfer Pricing Regulations

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) within 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.

16.8 Offences and penalties under Transfer Pricing Regulations 2018

- (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.

16.9 Deductibility of payment for intangibles to non-resident companies

The deductibility of payments for intangibles to non-resident companies is a complex issue that depends on various factors, including the tax laws of the country where the payer is resident and the nature of the intangible asset. Here's a general overview:

- a) **General principle**

In general, payments for intangibles, such as royalties, licensing fees, or technical service fees, are deductible expenses for tax purposes. However, the deductibility of these payments may be subject to certain conditions and limitations.

b) Conditions for deductibility

To be deductible, payments for intangibles to non-resident companies must typically meet the following conditions:

- i. **Business purpose:** The payment must be made for a legitimate business purpose, such as acquiring a necessary technology or expertise.
- ii. **Arm's length transaction:** The payment must be made at arm's length, meaning that the terms and conditions of the transaction must be comparable to those that would be agreed upon between unrelated parties.
- iii. **Documentation:** The payer must maintain adequate documentation to support the payment, including records of the transaction, the terms and conditions of the agreement, and the benefits received.
- iv. **Tax treaty requirements:** If the payer and the recipient are resident in different countries, the payment may be subject to the provisions of a tax treaty between the two countries.

c) Limitations on deductibility

There are several limitations on the deductibility of payments for intangibles to non-resident companies:

- i. **Withholding tax:** The payer may be required to withhold tax on the payment, which can reduce the amount of the payment that is deductible.
- ii. **Transfer pricing adjustments:** If the payment is not made at arm's length, the tax authorities may adjust the payment to reflect the arm's length price, which can affect the deductibility of the payment.
- iii. **Thin capitalisation rules:** If the payer is thinly capitalized, the tax authorities may disallow the deduction for the payment or recharacterise it as a dividend or interest payment.
- iv. **Anti-avoidance rules:** Tax authorities may have anti-avoidance rules that target payments for intangibles to non-resident companies, which can limit or deny the deductibility of the payment.

d) Country-specific rules

The deductibility of payments for intangibles to non-resident companies can vary significantly depending on the country where the payer is resident. For example:

- i. United States: The US tax code has specific rules for the deductibility of payments for intangibles, including the requirement that the payment be made pursuant to a written agreement.
- ii. Canada: Canadian tax law requires that payments for intangibles be made at arm's length and that the payer maintain adequate documentation to support the payment.
- iii. European Union: The EU has specific rules for the deductibility of payments for intangibles, including the requirement that the payment be made for a legitimate business purpose.

In conclusion, the deductibility of payments for intangibles to non-resident companies is a complex issue that depends on various factors, including the tax laws of the country where the payer is resident and the nature of the intangible asset. It is essential to consult with a tax professional to ensure compliance with the relevant tax laws and regulations.

16.10 Transfer pricing returns and due dates for filing

In Nigeria, the Federal Inland Revenue Service (FIRS) requires taxpayers to file various transfer pricing returns to demonstrate compliance with the country's transfer pricing regulations. Here are the types of transfer pricing returns and their filing due dates in Nigeria:

16.10.1 Types of transfer pricing returns

- i. Transfer pricing (TP) declaration form: A form that requires taxpayers to declare their related-party transactions and provide basic information about their transfer pricing policies.
- ii. Transfer pricing disclosure form: A form that requires taxpayers to provide detailed information about their related-party transactions, including the transfer pricing methodology used and the amounts involved.
- iii. Country-by-Country Reporting (CbCR) template: A template that requires taxpayers to provide a breakdown of their global revenue, profit, and taxes paid on a country-by-country basis.

16.10.2 Filing due dates

The filing due dates for transfer pricing returns in Nigeria are as follows:

- i. transfer pricing (TP) declaration form: Due on or before the June 30, of each year, covering the preceding calendar year;
- ii. transfer pricing disclosure form: Due on or before the September 30, of each year, covering the preceding calendar year; and
- iii. Country-by-Country Reporting (CbCR) Template: Due on or before the December 31, of each year, covering the preceding calendar year.

16.10.3 Additional requirements

Taxpayers in Nigeria are also required to:

- i. maintain transfer pricing documentation: Taxpayers must maintain contemporaneous transfer pricing documentation, including documentation on their transfer pricing policies, related-party transactions, and transfer pricing methodologies;
- ii. submit transfer pricing documentation upon request: Taxpayers must submit their transfer pricing documentation to the FIRS upon request.

16.11 Other relevant documentations required

16.11.1 Documentation

Transfer Pricing documentation will include:

- (a) transfer pricing policy;
- (b) transfer pricing compliance report; and
- (c) transfer pricing returns i.e. TP declaration and disclosure forms.

16.11.2 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; and
- (b) local transfer pricing policy.

16.11.3 Features of a transfer pricing policy

Features of a transfer pricing policy include:

- (a) typically, prospective in nature;
- (b) typically, not updated unless there are significant changes in Business;
- (c) provides a future view of likely intercompany transactions; and
- (d) provides guidance on pricing of the transactions and methodology.

16.11.4 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.

16.11.5 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.

16.11.6 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.

16.12 Chapter review

This chapter discusses the unique process of transfer pricing. Readers can appreciate the source and reasons for the transfer pricing. In addition, parties involved,

relevant basis for decisions, processes and procedures for transfer pricing are clearly stated.

Tax handling, offences and related penalties are highlighted. A good study of this chapter will reveal vividly, the usefulness of transfer pricing as a verifiable tool to curb tax evasion and aggressive avoidance by taxpayers.

16.13 Worked examples

16.13. Question

1. Transfer pricing refers to the rules and methods for pricing transactions within and between enterprises under common ownership or control. It plays a critical role in international taxation, as it determines how profits are allocated across different jurisdictions. The goal of transfer pricing regulations is to ensure that transactions between related entities are conducted at arm's length.

Required:

- a) Explain "arm's length price".
- b) Identify the items that constitute controlled transactions
- c) Identify the contents of the declaration form and disclosure form that should be submitted to the Federal Inland Revenue Service.

2. Multinational companies (MNCs) play a pivotal role in Nigeria's economic landscape, contributing significantly to sectors, such as oil and gas, telecommunications, banking, manufacturing, and agriculture. Their operations have introduced advanced technologies, global best practices, and foreign direct investment, which have helped stimulate economic growth, create employment, and enhance infrastructure development.

However, the activities of MNCs are not without controversy. Concerns persist over environmental degradation, tax avoidance, and the marginalisation of local enterprises, raising questions about equitable development and corporate accountability.

Required:

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.

3. Transfer pricing documentation refers to the detailed records that multinational enterprises are required to maintain to demonstrate that their intercompany transactions are conducted at arm's length. This documentation is essential for ensuring compliance with local and international tax regulations, providing transparency to tax authorities, and mitigating the risk of audits and penalties.

Required:

- (a) Explain key features of a transfer pricing policy.
 - (b) Explain any three key transfer pricing documentation.
4. In the context of transfer pricing, a 'connected person' refers to individuals or entities that have a direct or indirect relationship with a company, such that they can influence the terms and conditions of transactions between them.

Required:

Identify “connected persons” as described in the provisions of CITA, PPTA, PITA and OECD guidelines.

16.13.2 Suggested solutions to questions

1 (a) **Arm's length price:** This 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.

(b) **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.

(c) **Contents of a declaration form**

- 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
- x. Particulars of the person making the declaration

Contents of a disclosure form

- 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
- vii. Particulars of the person making the disclosure

2. 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 for example, 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 (for example, 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.

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.

Key features of a transfer pricing policy include:

- (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.

(b) Transfer pricing documentations include:

- (i) transfer pricing policy;
- (ii) transfer pricing compliance report; and
- (iii) transfer pricing returns, that is, transfer pricing declaration and disclosure form

4. 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 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 (that is, related parties) within the context of the Income Tax (Transfer Pricing), Regulations, 2018:

- (a) any entity dealing with a related party (associate, subsidiary, joint venture);
- (b) a member 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 is taxable under different regimes, for example, tax-exempt export profits;
- (h) loss making entity within a profitable group; and
- (i) related parties subject to tax at different rates.

BASE EROSION AND PROFIT SHIFTING

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17 Base Erosion and Profit Shifting

17.0 Learning objective

The learning objective of this chapter is to enable readers understand the tax evading and avoiding process referred to as base erosion and profit shifting as well as the recommended ways to overcoming it.

17.1 Learning outcomes

After studying this chapter, readers should be able to:

- (a) differentiate 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.

17.2 Introduction

17.2.1 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.

17.2.2 Profit shifting

Profit shifting involves making payment to other group companies 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.

17.3 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:

- (a) their international operations provide a ready-made network of companies through which group funds can flow;
- (b) they have capital to set up and maintain entities used for tax reduction purposes; and

- (c) 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.

17.4 Base erosion and profit shifting techniques

17.4.1 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.
- 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.

17.5 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 task 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.

17.6 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:

- (a) **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 or goods and services tax with respect to the cross-border supply of digital goods and services.
- (b) **Neutralise the effects of hybrid mismatch arrangements:** Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (for example, 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.
- (c) **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.
- (d) **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.

- (e) **Counter harmful tax practices more effectively, considering 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 based on the existing framework and consider revisions or additions to the existing framework.
- (f) **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 a tax treaty with another country. The work will be coordinated with the work on hybrids.
- (g) **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 using commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.
- (h) **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;
- (i) **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.
- (j) **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.

- (k) **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 (for example, FDI and balance of payments data) and micro-level data (for example, from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.
- (l) **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” 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.
- (m) **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.
- (n) **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.
- (o) **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.

17.7 Country-by-country reporting regulations FIRS specific

17.7.1 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:

- a) 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 (CbC) report in a specified format with the FIRS on an annual basis, provided that such entity is resident in Nigeria for tax purposes. The CbC report should be filed not later than 12 months after the last day of the reporting accounting year of the MNE Group;
- b) a constituent entity which is not the UPE of an MNE Group that meets certain conditions will also be required to file a CbC report with the FIRS within the time specified;
- c) a constituent entity will not be required to file a CbC report if same has been filed through a surrogate parent entity in the format specified in the regulations;
- d) failure to submit the CbC report within the time stipulated would attract a penalty of ₦10,000,000 in the first instance and ₦1,000,000 for every month in which the default continues; and
- e) 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.

17.7.2 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 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:

- (a) The Income Tax (Transfer Pricing) Regulations 2018;
- (b) 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; and

(c) 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 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.

17.8 Provisions of Finance Act of 2023 on CbCR reporting

The Finance Act of 2023 introduces changes to the country's tax laws, including Country-by-Country Reporting (CbCR) regulations. The key updates are itemised below.

a) CbCR regulations

The Act revises CbCR regulations, aligning them with global standards and best practices. Key changes include:

- i. **expanded reporting requirements:** Multinational Enterprises (MNEs) must now report more detailed information on their operations, including revenue, profit, and tax payments;
- ii. **increased transparency:** The Act promotes transparency by requiring MNEs to disclose more information about their business operations and tax strategies; and
- iii. **improved compliance:** The revised regulations aim to enhance compliance with tax laws and regulations, reducing the risk of tax evasion and avoidance.

b) Impact on taxpayers

The changes introduced by the Finance Act 2023 may impact taxpayers in various ways. These include:

- i. **increased reporting burden:** MNEs may need to adapt their reporting processes to meet the new requirements;
- ii. **enhanced disclosure:** Taxpayers must be prepared to disclose more information about their business operations and tax strategies; and
- iii. **compliance risks:** Failure to comply with the revised regulations may result in penalties and reputational damage.

c) Key focus areas

The Finance Act 2023 focuses on five key areas:

- i. **tax equity reforms:** Aiming to promote fairness and equity in taxation;
- ii. **climate change/green growth:** Encouraging sustainable practices and reducing environmental impact;
- iii. **job creation/economic growth:** Fostering economic growth and job creation;
- iv. **reforming tax incentives:** Reviewing and updating tax incentives to promote investment; and
- v. **revenue generation/tax administration:** Enhancing tax administration and revenue generation.

17.9 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 by group of companies. Besides this, 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.

17.10 Worked examples

17.10.1 Questions

1. Base erosion and profit shifting are advanced tax avoidance strategies usually adopted by multinational enterprises (MNEs).

Required:

Discuss any **FOUR** (4) techniques that could be used to achieve these tax avoidance strategies by MNEs.

2. The Organisation for Economic Cooperation and Development (OECD) in its effort to address the problems associated with base erosion and profit shifting, has issued a paper on various actions against the menace of base erosion and profit shifting. Thin capitalisation is also a tool for perfecting tax avoidance.

Required:

Discuss base erosion and profit shifting, and thin capitalisation.

3. Base erosion and profit shifting (BEPS) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions. In response, the Organisation for Economic Co-operation and Development (OECD), in collaboration with the G20, launched the BEPS Project to develop a comprehensive set of measures aimed at curbing these practices.

The OECD's BEPS Action Plan, consisting of 15 action points, provides governments with tools to ensure that profits are taxed where economic activities generating the profits are performed and where value is created. These actions promote transparency, coherence, and substance in international tax systems, helping to restore trust in the global tax framework.

Required:

Discuss Two (2) actions against base erosion and profit shifting as suggested by the OECD.

17.10.2 Suggested solution to questions

1. The following are the techniques usually adopted by the multinational enterprises (MNEs) to achieve base erosion and profit shifting tax avoidance strategies:
 - (i) **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.
 - (ii) **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.
 - (iii) **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.
 - (iv) **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. Relevant discussion points are as stated below.

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.

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. Another issue with these types of payment is that some jurisdictions have lower tax rates on them when received as income by other persons.

Thin capitalisation

This refers to intentional high gearing of a company for interest charges. Subsidiaries with minimal share capital are set up. A financing arm of the group is used 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.

3. **Actions against base erosion and profit shifting as suggested by the OECD**

(a) **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.

(b) **Neutralise the effects of hybrid mismatch arrangements**

Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (for example, 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); and
- (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and where necessary, guidance on coordination 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.

(c) **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.

(d) **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.

(e) **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.

REGIONAL INTEGRATION AND TRADE BLOCS

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18 Regional Integration and Trade Blocs

18.0 Learning objective

The learning objective of this chapter is to appreciate the relevance and importance of regional integration and trade blocs as basis for economic development.

18.1 Learning outcomes

After studying this chapter, readers should be able to:

- (a) differentiate 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.

18.2 Economic Community of West Africa State (ECOWAS)

18.2.1 Formation

Economic Community of West Africa State (ECOWAS) is a regional body created on May 25th, 1975, during its first conference in Lagos, where its treaty was signed. The idea of having a united West African body was first proposed by the then Nigerian Head of State, General 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 5 members. Later on, Cape Verde joined in 1976, but Mauritania withdrew its membership in December 2000. In 2024, the Sahel States of Burkina Faso, Mali and Niger also left ECOWAS. At the moment, the commission has 12 members namely Benin, Ghana, Nigeria, Cote d'Ivoire (Ivory Coast), Sierra Leone, Liberia, Guinea Bissau, Senegal, Togo, Guinea, Gambia, and Cape Verde. The main objective of ECOWAS is to promote co-operation and integration to create an economic and monetary union for encouraging economic growth and development in West Africa, through:

- (a) the suppression of customs duties and equivalent taxes;
- (b) the establishment of a common external tariff;
- (c) the harmonization of economic and financial policies; and
- (d) the creation of a monetary zone.

18.2.2 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 well-being 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 behaviour of fiscal policy rules in the context of regional economic integration within the ECOWAS.

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 mobilise 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.

18.2.3 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 goods 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 harmonising ECOWAS member states and strengthening its Common Market. 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 Organisation (WCO).

On October 25, 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:

- (a) safeguard measures;
- (b) anti-dumping measures;
- (c) anti-subsidy and countervailing measures; and
- (d) supplementary protection measures.

18.3 African Continental Free Trade Area (AfCFTA)

18.3.1 Objectives of the African Continental Free Trade Area (AfCFTA) Agreement

The AfCFTA Agreement aims to create a single, unified market for goods and services across the African continent, promoting economic integration, boosting intra-African trade, and enhancing Africa's global competitiveness. With 55 countries in its fold, AfCFTA is the largest free trade area in the world.

The key objectives are to:

- (a) **Create a single market:** Establish a single, unified market for goods and services, facilitating the movement of goods, services, and people across the continent.
- (b) **Boost intra-African trade:** Increase intra-African trade by reducing and eliminating tariffs, non-tariff barriers, and other trade restrictions.

- (c) **Enhance competitiveness:** Enhance Africa's global competitiveness by creating a more favourable business environment, improving infrastructure, and promoting investment.
- (d) **Promote economic integration:** Promote economic integration by creating a more cohesive and coordinated economic space, facilitating the free movement of goods, services, and people.
- (e) **Foster sustainable development:** Foster sustainable development by promoting economic growth, reducing poverty, and improving living standards.

18.3.2 Operations of the AfCFTA agreement

The AfCFTA Agreement is governed by several key instruments and institutions:

- (a) **Protocols:** The Agreement includes several protocols, such as the Protocol on Trade in Goods, the Protocol on Trade in Services, and the Protocol on Rules and Procedures for Dispute Settlement.
- (b) **Operational instruments:** The Agreement also includes several operational instruments, such as the Rules of Origin, the Tariff Concessions, and the Continental Online Tool for monitoring Non- Tariff Barriers.
- (c) **Institutional framework:** The Agreement establishes an institutional framework, including the Assembly, the Council of Ministers, the Committee of Senior Trade Officials, and the Technical Committees.
- (d) **Dispute settlement:** The Agreement establishes a dispute settlement mechanism to resolve trade disputes between member states.

18.3.3 Challenges in implementing the AfCFTA agreement

Despite its potential, the AfCFTA Agreement faces several challenges, such as:

- (a) **Tariff revenue losses:** Concerns about significant revenue losses and uneven distribution of costs and benefits.
- (b) **Adjustment costs:** Short-term structural changes, such as labor and capital relocation, may incur costs.
- (c) **Competitive pressures:** Increased competition may lead to market consolidation, potentially harming smaller firms.
- (d) **Implementation:** Effective implementation requires coordination among member states, addressing infrastructure gaps, and building institutional capacity.
- (e) **Non-tariff barriers:** Non-tariff barriers, such as bureaucratic procedures and regulatory requirements, may hinder trade.
- (f) **Infrastructure challenges:** Infrastructure challenges, such as inadequate transportation networks and energy supply, may hinder trade.
- (g) **Institutional capacity:** Weak institutional capacity, including inadequate human and financial resources, may hinder effective implementation.

18.4 Regional trading blocs in Africa in comparison to:

18.4.1 European Union (EU)

European Union (EU), international organisation comprising 27 European countries and governing common economic, social, and security policies. The EU's members are Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden. The United Kingdom, which had been a founding member of the EU, left the organisation in 2020.

The goals of the European Union are:

- (a) promote peace, its values and the well-being of its citizens;
- (b) sustainable development based on balanced economic growth and price stability, a highly competitive market economy with full employment and social progress, and environmental protection;
- (c) combat social exclusion and discrimination;
- (d) promote scientific and technological progress;
- (e) enhance economic, social and territorial cohesion and solidarity among EU countries;
- (f) respect its rich cultural and linguistic diversity; and
- (g) establish an economic and monetary union whose currency is the euro.

18.4.2 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:

- (a) more free trade resulting in greater choices in goods and services;
- (b) lower prices and improved quality products;
- (c) stronger health and safety standards;
- (d) improved economic stability in the U.S. marketplace; and
- (e) a marketplace that is increasingly driven more by supply and demand than by barriers to commerce.

18.5 Benefits of regional economic integration and-trade blocs

The benefits derivable from regional economic integration and trade blocs agreements include the following:

- (a) **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.
- (b) **Employment opportunities:** By removing restrictions on labour movement, economic integration can

help expand job opportunities.

- (c) **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.
- (d) **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 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.

18.6 Disadvantages of regional economic integration and trade blocs

Creation of regional economic integration and trade blocs agreements may result in the following disadvantages:

- (a) **Trade diversion:** The flip side to trade creation is trade diversion. Member countries may trade more with each other than with non-member 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 trading bloc.
- (b) **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.
- (c) **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.

18.7 Other regional trading blocs

18.7.1 Regional integration

This is a process in which neighbouring states enter into an agreement 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.

18.7.2 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.

18.8 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 fulfill at least the following eight important objectives:

- (a) the strengthening of trade integration in the region;
- (b) the creation of an appropriate enabling environment for private sector development;
- (c) the development of infrastructure programmes in support of economic growth and regional integration;
- (d) the development of strong public sector institutions and good governance;
- (e) the reduction of social exclusion and the development of an inclusive civil society
- (f) contribution to peace and security in the region;
- (g) the building of environment programmes at the regional level; and
- (h) the strengthening of the region's interaction with other regions of the world.

18.9 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:

(a) 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).

(b) 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.

(c) 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).

(d) **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).

18.10 Chapter review

This chapter distinguishes between regional integration and trade blocs. The chapter also dwells on objectives of regional integration and various forms of regional economic integration and trade blocs. The advantages and demerits of establishing common trading platforms were also highlighted.

18.11 Worked examples

18.11.1 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, on salient points, covering the following areas:

- (a) Differentiation 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.

Required:

Discuss the following:

- (a) Regional integration
- (b) Trade blocs
- (c) Agreements of regional economic integration and trade blocs

3. It is highly advantageous to nations that endeavour to come together, pool ideas and resources- Human and capital - together to form a common market. Despite the benefits that may accrue, it is surprising that as a result of cultural diversity and political differences which sometimes is based on the foreign policy of African nations' former colonial masters, nations remain sceptical and receptive to union of nations.

Despite the existing negative variables there should be unity among nations for the sake of prosperity and growth.

Required:

- (a) Discuss the salient points of the advantages of nations coming together to relate with one another as a group.
 - (b) Discuss **Two** (2) types of regional economic integration.
4. The founders of ECOWAS had a sincere intention of moving the countries of West Africa to a comparative position that could be likened to those of other developed countries of the world. Their unique and sensitive ideas demonstrated the love they had for their individual nations.

Required:

- (a) Discuss the original means of attaining the objectives of ECOWAS.
- (b) Explain the common external tariffs defense measures.

18.11.2 Suggested solutions to questions

1.

INTERNAL MEMO

From: Desk Officer

To: The Principal Partner

Date: April 9, 2025

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. The salient points are stated below:

(a) Differentiation between Regional Integration and Trade blocs

Regional integration

This is a process in which neighbouring states enter into an agreement 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. Examples of regional integration includes North American Free Trade Agreement and Asian Pacific Economic Cooperation Forum.

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

The objectives of regional integration are as follows:

- (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

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 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. 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

- (i) **Employment opportunities** - By removing restrictions on labour movement, economic integration can help expand job opportunities.
- (ii) **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.
- (iii) **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.

- (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.
 - (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**
- (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 non-member 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.
 - (iv) **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.
 - (v) Regional integration and trade blocs are forms of trade barriers with countries which are not members of the trading bloc.

I have commented on the aspects deemed necessary, nevertheless, I will be willing to supply additional information, where necessary.

Yours faithfully,

Femi Oworu

- 2(a) Regional integration is a process in which neighboring states enter into an agreement 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 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 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 these trading blocs with more than one hundred agreements in place and more in discussion.
- (c) The 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 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.

Creation of regional economic integration and trade bloc agreements may lead to the following disadvantages:

- (i) **Trade diversion:** The flip side to trade creation is trade diversion. Member countries may trade more with each other than with non-member 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 trading bloc.

- (ii) **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.
- (iii) **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.

3. (a) Salient points on advantages of nations coming together to relate as a group includes the following:

- (i) coming together of nations with comparative advantages will serve to strengthen trade integration in the region concerned;
- (ii) coming together of nations will directly create appropriate enabling environment for private sector development;
- (iii) coming together of nations will lead to the development of infrastructure programmes in support of economic growth and regional integration;
- (iv) coming together of nations will lead to the development of strong public sector institutions and good governance;
- (v) coming together of nations will lead to the reduction of social exclusion and the development of an inclusive civil society;
- (vi) coming together of nations will bring about joint security operations, thereby contributing to peace and security in the region;
- (vii) Coming together of nations will bring about the building of environment programmes at the regional level; and
- (viii) Coming together of nations will strengthen the region's interaction with other regions of the world.

(b) Types of regional economic integration

(i) 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).

(ii) 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).

4. (a) The original means of attaining the objectives of ECOWAS

- (i) The suppression of customs duties and equivalent taxes
- (ii) The establishment of a common external tariff
- (iii) The harmonisation of economic and financial policies
- (iv) The creation of a monetary zone

(b) The ECOWAS common external tariff (CET) and its accompanying trade defense measures

- (i) Safeguard measures
- (ii) Anti-dumping measures
- (iii) Anti-subsidy and countervailing measures
- (iv) Supplementary protection measures

INTERNATIONAL TAX POLICY

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19 International Tax Policy

19.0 Learning objective

The main objective of this chapter is to enable readers to understand international tax policy.

19.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

- (a) discuss the concept and objectives of international tax policy;
- (b) explain the concept of jurisdiction;
- (c) evaluate the roles being played by inter-governmental and supranational organisations that shape tax policy;
- (d) examine the roles of World Trade Organisation (WTO), General Agreement on Tariffs and Trade (GATT) and their significance to international taxation;
- (e) evaluate international cooperation between tax administrators in different tax jurisdictions in respect of exchange of information;
- (f) identify and explain practical aspects of Nigeria's exchange of information framework, its effectiveness and challenges encountered in enforcing cross-border compliance;
- (g) discuss the effectiveness of global cooperation and assistance on tax matters; and
- (h) evaluate the use of neutralities in international tax policy.

19.2 Introduction

Globalisation and technological revolution have had a tremendous effect on international taxation. Therefore, international organisations must play key roles in developing policy that will shape global tax administration.

19.3 Concepts and objectives of international tax policy

19.3.1 Concepts of international tax policy

- (a) Tax sovereignty: The right of a country to tax income earned within its borders.
- (b) Double taxation: Taxing the same income in multiple countries, potentially leading to increased tax burdens.
- (c) Tax avoidance: Minimising tax liabilities through legal means, often using international tax planning strategies.
- (d) Transfer pricing: Pricing transactions between related entities in different countries, which can impact tax liabilities.

19.3.2 Objectives of international tax policy

- (a) Fairness: Ensuring that taxpayers contribute to the public purse in a fair and equitable manner.
- (b) Efficiency: Minimising tax compliance costs and administrative burdens.
- (c) Neutrality: Avoiding tax policies that distort economic decisions or create

unintended incentives.

- (d) Competitiveness: Promoting a country's economic competitiveness by creating a favourable tax environment.
- (e) Revenue generation: Generating sufficient revenue for governments to fund public goods and services.

By understanding the concepts and objectives of international tax policy, governments and taxpayers can work together to create a fair, efficient, and competitive tax environment that supports economic growth and development.

19.4 Concept of jurisdiction

19.4.1 Tax jurisdiction

Tax jurisdiction refers to the authority of a country, state, or local government to impose taxes on individuals, businesses, or transactions. It determines which tax laws and regulations apply to a particular taxpayer or transaction.

(a) Types of tax jurisdiction

- (i) Residence-based jurisdiction: Taxpayers are taxed based on their residence or domicile.
- (ii) Source-based jurisdiction: Taxpayers are taxed based on the source of their income, regardless of their residence.

(b) Factors determining tax jurisdiction

- (i) Residency: Where an individual or business is considered a resident.
- (ii) Income source: Where income is earned or sourced.
- (iii) Permanent Establishment: Presence of a permanent establishment in a country.

9.4.2 Tax jurisdiction limits

Tax jurisdiction limits refer to the boundaries and constraints within which a tax authority can impose taxes. These limits are essential in determining the scope of a tax authority's power and ensuring that taxes are levied fairly and consistently.

(a) Types of limits

- (i) Geographical limits: Tax authorities can only impose taxes within their territorial boundaries.
- (ii) Subject matter limits: Tax authorities can only tax specific types of income, transactions, or activities.
- (iii) Personal limits: Tax authorities can only tax individuals or entities with a sufficient connection to the jurisdiction.

(b) Importance of tax jurisdiction limits

- (i) Preventing overreach: Limits prevent tax authorities from overreaching their authority and imposing taxes beyond their jurisdiction.

- (ii) Ensuring fairness: Limits help ensure that taxes are levied fairly and consistently, without arbitrary or discriminatory treatment.
- (iii) Protecting taxpayers: Limits protect taxpayers from excessive or unjustified taxation.

19.4.3 Tax Jurisdiction in cross-border tax collection and enforcement

Jurisdiction plays a crucial role in the collection and enforcement of cross-border taxes. It determines which tax authority has the power to collect taxes and enforce tax laws in cases involving multiple countries.

(a) Challenges in cross-border tax collection

- (i) Multiple jurisdictions: Multiple countries may claim taxing rights, leading to complexity and potential double taxation.
- (ii) Enforcement difficulties: Tax authorities may face challenges in enforcing tax laws and collecting taxes from foreign taxpayers.
- (iii) Information sharing: Tax authorities may need to share information with other jurisdictions to effectively enforce tax laws.

(b) Mechanisms for cross-border tax collection

- (i) Double taxation agreements (DTAs): DTAs help allocate taxing rights between countries and prevent double taxation.
- (ii) Tax treaties: Tax treaties provide frameworks for cooperation and information sharing between tax authorities.
- (iii) Mutual assistance: Countries may provide mutual assistance in tax collection and enforcement.

(c) Impact on tax administration

- (i) Complexity: Cross-border tax collection and enforcement can be complex, requiring specialised expertise.
- (ii) Risk management: Tax authorities must manage risks associated with cross-border tax collection and enforcement.
- (iii) International coordination: Effective jurisdiction requires international coordination and cooperation between tax authorities.

19.4.4 Tax jurisdiction source and residence

(a) Source-based jurisdiction

- (i) Definition: Taxing income based on its source, regardless of the taxpayer's residence.
- (ii) Application: Countries tax income earned within their borders, such as income from:
 - (iii) Business operations
 - (iv) Real estate
 - (v) Employment

(b) Residence-based jurisdiction

- (i) Definition: Taxing income based on the taxpayer's residence, regardless of the income's source.
- (ii) Application: Countries tax income earned by residents, including:
- (iii) Worldwide income
- (iv) Foreign-sourced income

19.4.5 Tax jurisdiction to controlled foreign companies

A Controlled Foreign Company (CFC) is a foreign subsidiary or affiliate controlled by a parent company in another country. Tax jurisdiction over CFCs is complex, as it involves the interaction of tax laws in multiple countries.

(a) Tax jurisdiction over CFCs

- (i) Parent company's country: The parent company's country may assert tax jurisdiction over the CFC's income, even if the income is earned in a different country.
- (ii) CFC's country: The country where the CFC is resident may also assert tax jurisdiction over the CFC's income.

(b) Implications

- (i) Double taxation: CFC taxation can lead to double taxation if both the parent company's country and the CFC's country tax the same income.
- (ii) Tax planning: Understanding CFC rules are crucial for tax planning and optimisation.
- (iii) International cooperation: CFC rules may require international cooperation and information sharing between tax authorities.

19.5 The roles being played by inter-governmental and supranational organisations that shape tax policy

International organisations 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 for Economic Cooperation and Development (OECD), United Nations (UN), European Union (EU), World Bank, International Monetary Fund (IMF), African Union (AU), African Development Bank (ADB).

The concept in terms of global governance promoted by the international organisations is legitimacy and customs.

(a) The roles being played by inter-governmental organisations that shape tax policy

Inter-governmental organisations play a crucial role in shaping tax policy globally. Here's an evaluation of their roles:

- (i) Setting global tax standards: Organisations like the Organisation for Economic Co-operation and Development (OECD) develop guidelines and standards for tax policies, helping countries avoid double taxation and tax evasion.
- (ii) Promoting tax cooperation: These organisations facilitate cooperation among countries, enabling them to address common tax challenges and develop effective tax policies.
- (iii) Developing frameworks for international taxation: Organisations like the OECD and the United Nations (UN) work on developing frameworks for international taxation, including rules for taxing cross-border transactions and digital economy taxation.

Notable organisations

- OECD: Develops guidelines and standards for tax policies, implements initiatives like the Base Erosion and Profit Shifting (BEPS) project to prevent tax avoidance, and provides technical assistance to developing countries.
- United Nations (UN): Provides a platform for countries to discuss and develop international tax policies, particularly for developing countries, and is working on a UN Tax Convention to democratise global tax rules.
- International Monetary Fund (IMF): Offers guidance on tax policy and administration, helping countries strengthen their tax systems.
- World Bank Group (WBG): Supports countries in building effective tax systems, providing technical assistance and financing for tax-related projects.

(b) The roles being played by supranational organisations that shape tax policy

Supranational organisations play a significant role in shaping tax policy globally. These organisations bring together countries to establish common tax standards, rules, and regulations, promoting cooperation and coordination. Here's an evaluation of their roles:

- (i) Setting global tax standards: Organisations like the Organisation for Economic Co-operation and Development (OECD) develop guidelines and standards for tax policies, helping countries to avoid double taxation and tax evasion.
- (ii) Promoting tax cooperation: Supranational organisations facilitate cooperation among countries, enabling them to address common tax challenges and develop effective tax policies.
- (iii) Developing frameworks for international taxation: Organisations like the OECD and the United Nations (UN) work on developing frameworks for

international taxation, including rules for taxing cross-border transactions and digital economy taxation.

Notable supranational organisations

- OECD: Develops guidelines and standards for tax policies and implements initiatives like the Base Erosion and Profit Shifting (BEPS) project to prevent tax avoidance.
- United Nations (UN): Provides a platform for countries to discuss and develop international tax policies, particularly for developing countries.
- International Monetary Fund (IMF): Offers guidance on tax policy and administration, helping countries to strengthen their tax systems.
- World Bank Group (WBG): Supports countries in building effective tax systems, providing technical assistance and financing for tax-related projects.
- European Union (EU): Develops and implements tax policies for its member states, including regulations on value-added tax (VAT) and corporate taxation.

19.6 The roles of World Trade Organisation (WTO), General Agreement on Tariffs and Trade (GATT) and their significance to international taxation

The World Trade Organisation (WTO) and the General Agreement on Tariffs and Trade (GATT) play significant roles in shaping international trade policies, which can impact international taxation.

19.6.1 Roles of World Trade Organisation (WTO)

- (a) Promoting free trade: Both WTO and GATT aim to reduce trade barriers, such as tariffs and quotas, to facilitate international trade.
- (b) Setting trade rules: They establish rules and standards for international trade, helping countries negotiate agreements and resolve disputes.
- (c) Facilitating negotiations: WTO and GATT provide platforms for countries to negotiate trade agreements, reducing tariffs and increasing market access.

19.6.2 Roles of General Agreement on Tariffs and Trade (GATT)

The General Agreement on Tariffs and Trade (GATT) is a multilateral trade agreement aimed at promoting free trade by reducing tariffs and other trade barriers. While primarily focused on trade, GATT has implications for international taxation.

- (a) Reducing tariffs: GATT aims to reduce tariffs and other trade barriers, facilitating international trade.
- (b) Promoting non-discrimination: GATT promotes non-discrimination in trade policies, ensuring equal treatment for imports from all member countries.
- (c) Setting trade rules: GATT establishes rules and standards for international trade, helping countries negotiate agreements and resolve disputes.

19.6.3 Significance to international taxation

- (a) Impact on tax revenues: GATT agreements can affect tax revenues by reducing tariffs and altering tax bases.
- (b) Customs valuation: GATT rules on customs valuation can impact taxation of imported goods.
- (d) Non-discrimination: GATT's non-discrimination principle can influence tax policies, ensuring equal treatment for imports from all member countries.
- (e) Trade-related tax issues: GATT addresses trade-related tax issues, such as tax discrimination and export subsidies.

19.7 International cooperation between tax administrators in different tax jurisdictions in respect of exchange of information

19.7.1 Exchange of Information on Request

Exchange of information on request is a crucial aspect of international cooperation between tax administrators. This mechanism allows tax authorities to request information from other jurisdictions to aid in tax audits, investigations, and compliance.

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 of the Requested State is not sufficient, it shall take all relevant measures to provide the Applicant State with the information requested.

19.7.2 Automatic exchange of information

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 automatically transmit information that is foreseeably relevant for the administration or enforcement of their domestic laws concerning the taxes covered by the convention.

19.7.3 Spontaneous Exchange of Information

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.

19.8 Nigeria's exchange of information framework

Nigeria's exchange of information framework is governed by the Nigeria Data Protection Act, which sets guidelines for cross-border data transfers. Key aspects include:

- (a) Adequate level of protection: Data controllers and processors must ensure the recipient country has adequate data protection laws or binding corporate rules.
- (b) Express consent: Data subjects must consent to the transfer, or it must be necessary for a contract, public interest, or legal claims.
- (c) Whitelist: The Attorney General's office maintains a whitelist of countries with adequate data protection laws.

19.8.1 Effectiveness

The framework aims to protect personal data while facilitating international trade and cooperation. Its effectiveness is evident in:

- (a) Regulatory oversight: The Nigeria Data Protection Bureau and the Attorney General's office oversee data protection and cross-border transfers.
- (b) Harmonisation efforts: Nigeria's framework aligns with global data protection best practices, such as the GDPR.

19.8.2 Challenges

Despite the framework's strengths, challenges persist:

- (a) Bureaucracy: Obtaining an Adequacy Decision can be time-consuming, and the white-list hasn't been updated since 2020.
- (b) Inadequate infrastructure: Insufficient data protection regulations in various countries hinder seamless cross-border transfers.
- (c) Capacity building: There's a need for increased awareness and capacity building on data protection in Nigeria.
- (d) Harmonisation: Achieving a unified African data protection legislation would facilitate smoother cross-border data flows.

19.9 The effectiveness of global cooperation

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:

- 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.

19.10 Neutralities in international tax policy

A neutral tax is one that does not motivate firms or individuals to change their behaviour. 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.

19.10.1 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 minimises 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 policymakers.

19.10.2 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 behaviour: Credits instead of educations

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.

19.11 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 organisations and their roles in global economic governance.

19.12 Worked examples

19.12.1 Questions

1. The global alignment not only strengthens Nigeria's tax enforcement capabilities but also fosters trust and cooperation with international partners. Together, these frameworks demonstrate Nigeria's evolving capacity to manage and exchange information securely, efficiently, and in alignment with global best practices.

Required:

Discuss the practical aspects of Nigeria's exchange of information framework, its effectiveness and challenges encountered in enforcing cross-border compliance.

2. The World Trade Organisation (WTO) and the General Agreement on Tariffs and Trade (GATT) play significant roles in shaping international trade policies, which can impact international taxation.

Required:

Discuss the following:

- (a) The impact of GATT on international taxation.
 - (b) The impact of GATT's dispute settlement mechanism on international taxation.
3. Cross-border transactions in Nigeria are increasingly vital to the country's economic growth, driven by globalization, foreign direct investment (FDI), and regional integration efforts such as the African Continental Free Trade Agreement (AfCFTA). However, navigating these transactions involves a complex web of regulatory requirements that span multiple legal domains.

Despite these frameworks, businesses face challenges such as jurisdictional conflicts, documentation burdens, tax complexities, and compliance with anti-money laundering (AML) regulations.

Required:

- (a) Discuss the regulatory complexities in cross-border transactions in Nigeria.
- (b) Discuss the impact of Nigeria's tax framework on cross-border transactions.
- (c) Discuss the ways by which disputes are resolved.

19.12.2 Suggested solutions to questions

1. Nigeria's exchange of information framework plays a crucial role in enhancing tax compliance and enforcement across borders. Here are some practical aspects, effectiveness, and challenges:

(a) Practical aspects

- (i) **Information exchange agreements:** Nigeria has signed information exchange agreements with several countries, enabling the automatic exchange of financial information to combat tax evasion.
- (ii) **Cross-border tax administration:** The framework streamlines tax compliance processes, reducing the complexity of cross-border transactions and enhancing the efficiency of tax administration.
- (iii) **Common reporting standard (CRS):** Nigeria's participation in global initiatives, such as the automatic exchange of information (AEOI) and the common reporting standard (CRS), facilitate cooperation with other countries in tax matters.

(b) Effectiveness

- (i) **Improved tax compliance:** The framework has improved tax compliance by enabling the exchange of information between countries, reducing the opportunities for tax evasion.
- (ii) **Enhanced transparency:** The AEOI and CRS initiatives promote transparency in tax matters, enabling countries to identify and address tax avoidance and evasion schemes.

(c) Challenges

- (i) **Robust rules:** Nigeria's ability to benefit from new international standards providing for automatic exchange is compromised by the absence of robust rules with respect to information exchange.
- (ii) **Capacity building:** The effectiveness of the framework depends on Nigeria's capacity to implement and utilise the exchanged information effectively.
- (iii) **Cross-border complexity:** The complexity of cross-border transactions and the varying regulatory frameworks can create challenges in enforcing compliance.

- 2.(a) GATT's provisions on tariffs and trade barriers have significant implications for international taxation. By reducing tariffs and promoting transparency in trade policies, GATT helps to:

- (i) **Minimise double taxation:** By reducing tariffs, GATT minimises the risk of double taxation on imported goods.
 - (ii) **Promote tax neutrality:** GATT's principles of non-discrimination and transparency promote tax neutrality, ensuring that tax policies do not unfairly disadvantage foreign goods or services.
 - (b) GATT's dispute settlement mechanism provides a framework for resolving trade disputes among member countries. This mechanism helps to:
 - (i) **Enforce tax compliance:** By resolving disputes, GATT's mechanism ensures that member countries comply with their tax obligations.
 - (ii) **Promote tax cooperation:** The dispute settlement mechanism fosters cooperation among member countries, promoting a more transparent and predictable tax environment.
- 3.(a)** Different jurisdictions have diverse legal, compliance, and regulatory requirements. Parties must consider varying tax laws, import and export restrictions, administrative costs, foreign exchange regulations, anti-money laundering laws, and other similar requirements. Compliance with these laws is essential to ensure legal and regulatory compliance.
- (b)** Cross-border transactions may trigger tax liabilities in multiple jurisdictions. Nigeria has operational double taxation treaties with 15 countries, which can provide relief from double taxation, reduced tax rates, or exemption of income from tax. Parties must carefully consider tax implications to ensure compliance, minimise tax exposure, and achieve tax efficiency.
- (c)** Parties can agree to refer disputes to a neutral third party via mediation or arbitration. International arbitration institutions like the International Chamber of Commerce play a vital role in administering cross-border arbitration proceedings. Nigeria is also a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

CURRENT TAX ISSUES

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19 Current Tax Issues

20.0 Learning objective

The objective of this chapter is for readers to appreciate current tax issues that could easily impact on their day-to-day economic activities.

20.1 Learning outcomes

After studying this chapter, readers should be able to explain the following:

- (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; and
- (g) African Continental Free Trade Area Agreement (ACFTA).

20.2 Tax inspectors without borders

The current wave of globalisation and technological revolution has had a tremendous effect on international taxation. The financial and economic liberalisation 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.

Tax Inspectors without borders (TIWB) is a joint new initiative of the Organisation 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 mobilisation (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 audits 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 Simultaneous tax examination

A simultaneous tax examination is an arrangement between two or more countries to examine the tax affairs of a person or entity simultaneously, but independently, in each country. This approach allows tax authorities to:

- a. exchange information and coordinate efforts to ensure accurate taxation;
- b. minimise the risk of double taxation and tax disputes; and
- c. streamline tax audits and examinations.

20.4.1 Benefits of simultaneous tax examination

- a. It encourages taxpayers to comply with tax laws and regulations.
- b. It helps detect and prevent tax evasion and avoidance schemes.
- c. It fosters cooperation and collaboration between tax authorities.

20.4.2 Key considerations

- a. It requires careful coordination and communication between tax authorities
- b. It must ensure confidentiality and protection of taxpayer information
- c. It may involve complex tax laws and regulations

The Organisation for Economic Co-operation and Development (OECD) and other tax authorities have developed toolkits and guidelines to facilitate simultaneous tax examinations and joint audits. These initiatives aim to promote cooperation, reduce tax disputes, and ensure fair taxation.

20.5 The 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.

20.6 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 service 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.

20.7 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.

20.8 Disruptive technologies

Disruptive technologies are significantly impacting tax administration, particularly in the digital economy. Some key technologies and challenges include:

- a. **Digital platforms:** e-commerce platforms, app stores, and online payment services are creating new tax compliance challenges. Tax authorities are struggling to track and collect taxes from digital transactions.
- b. **Artificial intelligence (AI) and Data Analytics:** Advanced technologies like AI and data analytics can enhance tax compliance and enforcement. However, they also require significant investment and expertise to implement effectively.
- c. **Blockchain and cryptocurrencies:** The rise of blockchain and cryptocurrencies have introduced new complexities in tax administration, such as tracking and taxing cryptocurrency transactions.
- d. **Cloud Computing:** Cloud computing enables businesses to operate remotely, making it challenging for tax authorities to determine the source of income and profits.
- e. **Data Analytics:** Advanced data analytics can help tax authorities identify tax compliance risks, detect anomalies, and optimise audit strategies.

20.8.1 Benefits of disruptive technologies

- a. **Improved efficiency:** Disruptive technologies can automate manual processes, reducing administrative burdens and improving efficiency.

- b. **Enhanced compliance:** Advanced technologies can help tax authorities detect tax evasion and improve compliance.
- c. **Data security:** Disruptive technologies can also introduce new data security risks, requiring tax authorities to implement robust security measures.

20.8.2 Future directions

- a. **Tax technology (TaxTech):** The intersection of tax and technology will continue to evolve, with emerging technologies like AI, blockchain, and data analytics playing a key role in shaping the future of tax administration.
- b. **Collaboration and Innovation:** Tax authorities, governments, and private sector organisations will need to collaborate and innovate to harness the potential of disruptive technologies and improve tax administration.

20.9 Chapter review

This chapter examines current issues. Readers must have learnt how to explain some issues in international tax as it affects cross-border transactions.

20.10 Worked examples

20.10.1 Questions

1. In Nigeria, where tax authorities are increasingly engaging with global standards and practices, simultaneous tax examinations offer a strategic tool.

Required:

Discuss simultaneous tax examination, its benefits and key considerations.

2. Current tax issues are necessary and relevant to all the actors in a particular economy. It is highly educative and tends to protect the interest of corporate taxpayers as well as trading nations.

Required:

Discuss mutual agreement procedures (MAP) and disruptive technology.

3. Tax Inspectors Without Borders (TIWB) is a flagship initiative jointly led by the OECD and UNDP. Over the past decade, TIWB has supported over 70 jurisdictions, helping to mobilise more than US\$2.4 billion in additional tax revenues, with Africa alone accounting for US\$1.91 billion

Required:

Discuss the workings of tax inspectors without border and the recent year's approach of a number of tax authorities on cooperation compliance.

20.10.2 Suggested solutions to questions

1. Simultaneous tax examination is an arrangement between two or more countries to examine the tax affairs of a person or entity simultaneously, but independently, in each country. This approach allows tax authorities to:

- (i) exchange information and coordinate efforts to ensure accurate taxation;
- (ii) minimise the risk of double taxation and tax disputes; and
- (iii) streamline tax audits and examinations.

Benefits of simultaneous tax examination include the following:

- (i) it encourages taxpayers to comply with tax laws and regulations
- (ii) it helps detect and prevent tax evasion and avoidance schemes
- (iii) it fosters cooperation and collaboration between tax authorities

Key Considerations

- (i) it requires careful coordination and communication between tax authorities.
- (ii) it must ensure confidentiality and protection of taxpayer information.
- (iii) it may involve complex tax laws and regulations.

2. 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.

On the other hand, disruptive technologies are significantly impacting tax administration, particularly in the digital economy. Some key technologies and challenges include

Digital Platforms: E-commerce platforms, app stores, and online payment services are creating new tax compliance challenges. Tax authorities are struggling to track and collect taxes from digital transactions.

Artificial Intelligence and data analytics: Advanced technologies like AI and data analytics can enhance tax compliance and enforcement. However, they also require significant investment and expertise to implement effectively.

Blockchain and cryptocurrencies: The rise of blockchain and cryptocurrencies is introducing new complexities in tax administration, such as tracking and taxing cryptocurrency transactions.

Cloud computing: Cloud computing enables businesses to operate remotely, making it challenging for tax authorities to determine the source of income and profits.

3. **Tax Inspectors Without Borders (TIWB)**

This is a joint new initiative of the Organisation 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 mobilisation (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 audits 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.

Recent year's approach to cooperation and compliance:

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.

EMERGING TRENDS

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- 21.1 Learning outcomes
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21 Emerging Trends

21.0 Learning objective

The objective of this chapter is to enhance readers' understanding of local and global emerging trends as they affect tax processes.

21.1 Learning outcomes

After studying this chapter, readers should be able to explain the:

- a) core goals of sustainable development;
- b) role of taxation in the achievement of sustainable development;
- c) tax challenges in Africa and its impact on sustainable development; and
- d) United nation development programme 2021 on tax for SDGs.

21.2 Introduction to sustainable development

Sustainable development is an approach to growth and progress that balances economic, social, and environmental needs, ensuring a lovable future for generations to come. It's about meeting the needs of the present without compromising the ability of future generations to meet their own needs.

21.2.1 Key aspects of sustainable development

- a) **Economic growth:** Sustainable development promotes economic growth that is environmentally friendly and socially inclusive.
- b) **Social inclusion:** It aims to reduce poverty and inequality, ensuring that everyone has access to basic needs like healthcare, education, and clean water.
- c) **Environmental protection:** Sustainable development prioritises the protection of natural resources, biodiversity, and ecosystems, recognizing the importance of a healthy environment for human well-being.

21.2.2 Principles of sustainable development

- a) **Intergenerational equity:** Considering the needs and well-being of current and future generations.
- b) **Environmental stewardship:** Protecting and preserving natural resources for future generations.

21.2.3 Achieving sustainable development

- a) **Renewable energy:** Transitioning to renewable energy sources to reduce dependence on fossil fuels.
- b) **Sustainable agriculture:** Promoting sustainable agricultural practices to ensure food security and reduce environmental impact.

- c) **Responsible consumption:** Encouraging responsible consumption patterns to reduce waste and minimize environmental footprint.

By adopting sustainable development practices, we can create a more equitable, prosperous, and environmentally conscious world for all.

21.3 Core goals of sustainable development

The core goals of sustainable development are outlined in the 17 Sustainable Development Goals (SDGs) adopted by the United Nations in 2015. These goals aim to achieve a balance between economic growth, social well-being, and environmental protection. The 17 SDGs are discussed below:

- a. **Eradicate poverty:** End poverty in all its forms and dimensions, promoting sustainable, inclusive, and equitable economic growth.
- b. **Zero hunger:** End hunger, achieve food security, and promote sustainable agriculture.
- c. **Good health and well-being:** Ensure healthy lives and promote well-being for all at all ages.
- d. **Quality education:** Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.
- e. **Gender equality:** Achieve gender equality and empower all women and girls.
- f. **Clean water and sanitation:** Ensure availability and sustainable management of water and sanitation for all.
- g. **Affordable and clean energy:** Ensure access to affordable, reliable, sustainable, and modern energy for all.
- h. **Decent work and economic growth:** Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all.
- i. **Industry, innovation, and infrastructure:** Build resilient infrastructure, promote inclusive and sustainable industrialization, and foster innovation.
- j. **Reduced inequalities:** Reduce inequality within and among countries.
- k. **Sustainable cities and communities:** Make cities and human settlements inclusive, safe, resilient, and sustainable.
- l. **Responsible consumption and production:** Ensure sustainable consumption and production patterns.
- m. **Climate action:** Take urgent action to combat climate change and its impacts.
- n. **Life below water:** Conserve and sustainably use the oceans, seas, and marine resources for sustainable development.
- o. **Life on land:** Protect, restore, and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt biodiversity loss.

- p. **Peace, justice, and strong institutions:** Promote peaceful and inclusive societies for sustainable development, provide access to justice for all, and build effective, accountable, and inclusive all levels.
- q. **Partnerships for the goals:** Strengthen the means of implementation and revitalise the global partnership for sustainable development.

These goals are interconnected and aim to address various aspects of sustainable development, including economic growth, social inclusion, and environmental protection.

21.4 Role of taxation in the achievement of sustainable development

Taxation plays a crucial role in achieving sustainable development. It is described as a dynamic form of social contract.

Taxation plays the under listed roles in the achievement of sustainable development of a nation:

- a) **Generating revenue:** Taxation provides the government with the necessary funds to invest in sustainable development projects, such as infrastructure, education, and healthcare.
- b) **Redistributing wealth:** Taxation can help reduce income inequality by redistributing wealth from the rich to the poor through progressive taxation and social welfare programs.
- c) **Influencing behaviour:** Taxation can influence behaviour by discouraging harmful activities, such as pollution, and encouraging sustainable practices, such as renewable energy production.
- d) **Promoting economic growth:** Taxation can promote economic growth by providing incentives for investment, innovation, and entrepreneurship.
- e) **Funding public goods and services:** Taxation helps fund public goods and services, such as healthcare, education, and infrastructure, which are essential for sustainable development.

21.4.1 Key taxation strategies for sustainable development

- a. **Green taxes:** Implementing taxes on activities that harm the environment, such as carbon emissions, to discourage their use.
- b. **Tax incentives:** Offering tax incentives for investments in sustainable development projects, such as renewable energy or sustainable infrastructure.
- c. **Progressive taxation:** Implementing progressive taxation to reduce income inequality and redistribute wealth.
- d. **Tax transparency:** Promoting tax transparency and accountability to prevent tax evasion and ensure that taxes are used for sustainable development.

21.5 Tax challenges

- a) **Balancing economic growth and sustainability:** Taxation policies need to balance economic growth with sustainability goals, ensuring that economic development does not come at the expense of environmental degradation.
- b) **International cooperation:** Taxation policies need to be coordinated internationally to address global sustainability challenges, such as climate change.
- c) **Tax capacity and administration:** Governments need to strengthen their tax capacity and administration to effectively implement taxation policies for sustainable development.
- d) By leveraging taxation, governments can promote sustainable development, reduce inequality, and ensure that economic growth is environmentally sustainable.

21.5.1 The challenges

Africa faces significant tax challenges that impact sustainable development. Some of the key challenges include:

- a) **Limited tax capacity:** Many African countries struggle to formulate tax capacities and mobilise domestic resources, hindering their ability to achieve sustainable development goals.
- b) **Tax evasion and avoidance:** Weak tax administration and lack of transparency can lead to tax evasion and avoidance, depriving governments of much-needed revenue.
- c) **Digital economy taxation:** The rise of the digital economy poses new tax challenges, including ensuring that digital businesses contribute fairly to the tax base.
- d) **Informal economy:** A significant portion of Africa's economy operates in the informal sector, making it difficult to track and tax economic activity.
- e) **Revenue mobilisation:** African countries need to improve revenue mobilisation to fund public goods and services essential for sustainable development.

21.5.2 The weight of tax challenges on sustainable development

- a. **Reduced funding:** Inadequate tax revenue can limit funding for essential public services, such as healthcare, education, and infrastructure.
- b. **Inequality:** Weak tax systems can exacerbate income inequality, as those who evade or avoid taxes may have an unfair advantage over those who comply.
- c. **Limited economic growth:** Tax challenges can hinder economic growth by discouraging investment and innovation.

21.5.3 Handling tax challenges

Addressing these tax challenges is crucial for achieving sustainable development goals in Africa. This can be achieved through:

- a. **Strengthening tax administration:** Improving tax administration and increasing transparency can help reduce tax evasion and avoidance.
- b. **Investing in tax capacity:** Building tax capacity and mobilizing domestic resources can help African countries fund public goods and services.
- c. **Promoting tax cooperation:** International cooperation and knowledge sharing can help African countries learn from best practices and address common tax challenges.

21.6 United Nations Development Programme 2021 on tax for SDGs

The United Nations Development Programme (UNDP) launched the "Tax for SDGs" initiative in 2021 to help countries leverage taxation and mobilise domestic resources to achieve the Sustainable Development Goals (SDGs). This initiative supports developing nations in strengthening their economic resilience against external shocks and equips national tax administrations and finance ministries with the skills and knowledge to combat tax evasion and align tax policies with the SDGs.

21.6.1 Key Objectives

- a) **Strengthening tax systems:** Enhance tax policy and revenue administration to support sustainable development.
- b) **Domestic resource mobilisation:** Increase domestic resource mobilisation (DRM) to fund public goods and services essential for achieving the SDGs.
- c) **Promoting sustainable growth:** Encourage sustainable growth strategies and influence behaviour towards desired outcomes related to climate, nature, well-being, and governance

21.6.2 Implementation

- a) The initiative covers multiple countries including Uzbekistan, where it supports comprehensive tax reform and aims to simplify taxation, improve the business environment, and trigger economic growth.
- b) The Tax for SDGs Initiative developed an assessment tool to help countries identify ways to better align their tax systems with the SDGs.
- c) It also includes launching the Tax Inspectors Without Borders (TIWB) Program, a joint initiative of UNDP and OECD.

21.6.3 Tools and resources

- a) **SDG taxation framework:** A comprehensive tool designed for national governments to optimise the linkage of a country's tax system with the SDGs.

- b) **Tax for SDGs Dialogue:** An annual event convening high-level policymakers, diplomats, tax administrators, and experts to discuss how fiscal policies and tax reforms can help realize the 2030 Agenda

21.6.4 Outcomes of programme

The United Nations Development Programme's (UNDP) "Tax for SDGs" initiative, launched in 2021, aims to help countries leverage taxation to achieve the Sustainable Development Goals (SDGs). Key outcomes and expected results are as follows:

- a) **Increased domestic resource mobilisation:** Enhancing tax systems to support sustainable development and reduce dependence on external financing.
- b) **Improved tax administration:** Strengthening tax authorities' capacity to tackle tax avoidance, evasion, and illicit financial flows.
- c) **Alignment of tax policies with SDGs:** Encouraging governments to align tax and fiscal policies with the SDGs, promoting sustainable growth strategies and influencing behavior towards desired outcomes.
- d) **Digitalisation of tax services:** Supporting the digitalisation of tax services to improve efficiency and effectiveness.
- e) **Gender equality:** Promoting gender-neutral economic outcomes through taxation and implementing the gender equality seal standard.
- f) **Tax inspectors without borders (TIWB) program:** Launching the TIWB program to enhance tax audit effectiveness, generating more revenues to fund SDG-related initiatives.

21.6.5 Extent of coverage

- a) Covered 25 countries in 2022, with the number increasing substantially in 2023.
- b) Developed an assessment tool to help countries align their tax systems with the SDGs.
- c) Supported countries in promoting sustainable development through informed tax policies.
- d) Collaborated with the OECD on the TIWB initiative, helping raise over \$2 billion in additional tax revenue since 2015.
- e) Overall, the Tax for SDGs initiative aims to support countries in achieving the SDGs by leveraging taxation as a tool for revenue collection and sustainable development.

21.7 Chapter review

This chapter -emerging trends- examines a dynamic area of present living and preparation for the future generation. Readers must have learnt, among others, the core goals, role of taxation, united nation contributions and the effect of disruptive technology as they affect emerging trends.

21.8 Worked examples

21.8.1 Questions

1. Nature is highly dynamic and prone to changes. People must make provision for its future. Our present living conditions, emerging trends and all its associated variables should form the basis of making provision for the future.

Required:

Discuss how tax challenges affect sustainable development and growth in emerging countries, like Nigeria.

2. Achieving sustainability developments is a direct response to emerging trends. This ensures that adequate provision is made for the future and our ever-growing population is not exposed to the risks that may lead to possible gradual extinction

Required:

Discuss the salient points of sustainability development core goals.

3. The United Nations, playing its role of adding value to developing nations of the world, introduced the United Nations development programme 2021 on tax for sustainability development.

Required:

Discuss the content of this unique contribution.

4. Tax challenges in Africa and its impact on sustainability development is one of the major areas needing urgent and proactive approach

Required:

Discuss the:

- a. Basic principles of sustainability development and key taxation strategies for sustainable development
- b. Tax challenges in Africa and its impact on sustainability development

21.8.2 Suggested solutions to questions

1. The effects of tax challenges on sustainable development and growth

Tax challenges

- (a) **Limited tax capacity:** Many African countries struggle to formulate tax capacities and mobilise domestic resources, hindering their ability to achieve sustainable development goals.
 - (b) **Tax evasion and avoidance:** Weak tax administration and lack of transparency can lead to tax evasion and avoidance, depriving governments of much-needed revenue.
 - (c) **Digital economy taxation:** The rise of the digital economy poses new tax challenges, including ensuring that digital businesses contribute fairly to the tax base.
 - (d) **Informal economy:** A significant portion of Africa's economy operates in the informal sector, making it difficult to track and tax economic activity.
 - (e) **Revenue mobilisation:** African countries need to improve revenue mobilisation to fund public goods and services essential for sustainable development.
2. The core goals of sustainable development, outlined in the 17 Sustainable Development Goals (SDGs) adopted by the United Nations in 2015 are discussed below:
- (a) **Eradicate poverty:** End poverty in all its forms and dimensions, promoting sustainable, inclusive, and equitable economic growth.
 - (b) **Zero hunger:** End hunger, achieve food security, and promote sustainable agriculture.
 - (c) **Good health and well-being:** Ensure healthy lives and promote well-being for all at all ages.
 - (d) **Quality education:** Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.
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 - (h) **Decent work and economic growth:** Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent

work for all.

- (i) **Industry, innovation, and infrastructure:** Build resilient infrastructure, promote inclusive and sustainable industrialization, and foster innovation.
- (j) **Reduced inequalities:** Reduce inequality within and among countries.
- (k) **Sustainable cities and communities:** Make cities and human settlements inclusive, safe, resilient, and sustainable.
- (l) **Responsible consumption and production:** Ensure sustainable consumption and production patterns.
- (m) **Climate action:** Take urgent action to combat climate change and its impacts.
- (n) **Life below water:** Conserve and sustainably use the oceans, seas, and marine resources for sustainable development.
- (o) **Life on land:** Protect, restore, and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt biodiversity loss.
- (p) **Peace, justice, and strong Institutions:** Promote peaceful and inclusive societies for sustainable development, provide access to justice for all, and build effective, accountable, and inclusive all levels.
- (q) **Partnerships for the goals:** Strengthen the means of implementation and revitalise the global partnership for sustainable development.

These goals are interconnected and aim to address various aspects of sustainable development, including economic growth, social inclusion, and environmental protection

3. The United Nations Development Programme (UNDP) launched the "Tax for SDGs" initiative in 2021 to help countries leverage taxation and mobilise domestic resources to achieve the Sustainable Development Goals (SDGs). This initiative supports developing nations in strengthening their economic resilience against external shocks and equips national tax administrations and finance ministries with the skills and knowledge to combat tax evasion and align tax policies with the SDGs.

Key objectives

Strengthening tax systems: Enhance tax policy and revenue administration to support sustainable development.

Domestic resource mobilisation: Increase domestic resource mobilisation (DRM) to fund public goods and services essential for achieving the SDGs.

Promoting sustainable growth: Encourage sustainable growth strategies and influence behaviour towards desired outcomes related to climate, nature, well-being, and governance

Implementation: The initiative covers multiple countries, including Uzbekistan, where it supports comprehensive tax reform and aims to simplify taxation, improve the business environment, and trigger economic growth.

The tax for SDGs Initiative developed an assessment tool to help countries identify ways to better align their tax systems with the SDGs.

It also includes launching the Tax Inspectors Without Borders (TIWB) Program, a joint initiative of UNDP and OECD

Tools and resources

SDG taxation framework: A comprehensive tool designed for national governments to optimise the linkage of a country's tax system with the SDGs.

Tax for SDGs dialogue: An annual event convening high-level policymakers, diplomats, tax administrators, and experts to discuss how fiscal policies and tax reforms can help realize the 2030 Agenda

Outcomes of programme

The United Nations Development Programme's (UNDP) "Tax for SDGs "initiative, launched in 2021, aims to help countries leverage taxation to achieve the Sustainable Development Goals (SDGs). Key outcomes and expected results.

Increased domestic resource mobilisation: Enhancing tax systems to support sustainable development and reduce dependence on external financing.

Improved tax administration: Strengthening tax authorities' capacity to tackle tax avoidance, evasion, and illicit financial flows.

Alignment of tax policies with SDGs: Encouraging governments to align tax and fiscal policies with the SDGs, promoting sustainable growth strategies and influencing behaviour towards desired outcomes.

Digitalisation of tax services: Supporting the digitalization of tax services to improve effectiveness.

Gender equality: Promoting gender-neutral economic outcomes through taxation and implementing the Gender Equality Seal standard.

Tax inspectors without borders (TIWB) programme: Launching the TIWB programme to enhance tax audit effectiveness, generating more revenues to fund SDG-related initiatives.

Extent of coverage

Covered 25 countries in 2022, with the number increasing substantially in 2023

Developed an assessment tool to help countries align their tax systems with the SDGs.

Supported countries in promoting sustainable development through informed tax policies.

Collaborated with the OECD on the TIWB initiative, helping raise over \$2 billion in additional tax revenue since 2015.

Overall, the Tax for SDGs initiative aims to support countries in achieving the SDGs by leveraging taxation as a tool for revenue collection and sustainable development.

4(a) The principles of sustainable development include:

- (i) **Intergenerational equity:** Considering the needs and well-being of both current and future generations.
- (ii) **Environmental stewardship:** Protecting and preserving natural resources for future generations.

Key tax objectives

- (i) **Strengthening tax systems:** Enhance tax policy and revenue administration to support sustainable development.
- (ii) **Domestic resource mobilisation:** Increase domestic resource mobilisation (DRM) to fund public goods and services essential for achieving the SDGs.
- (iii) **Promoting sustainable growth:** Encourage sustainable growth strategies and influence behavior towards desired outcomes related to climate, nature, well-being, and governance.

(b) Tax challenges impacting sustainability development in Africa

Africa faces significant tax challenges that impact sustainable development. Some of the key challenges include:

- (i) **Limited tax capacity:** Many African countries struggle to formulate tax capacities and mobilise domestic resources, hindering their ability to achieve sustainable development goals.
- (ii) **Tax evasion and avoidance:** Weak tax administration and lack of transparency can lead to tax evasion and avoidance, depriving governments of much-needed revenue.
- (iii) **Digital economy taxation:** The rise of the digital economy poses new tax challenges, including ensuring that digital businesses contribute fairly to the tax base.

- (iv) **Informal economy:** A significant portion of Africa's economy operates in the informal sector, making it difficult to track and tax economic activity. And
- (v) **Revenue mobilisation:** African countries need to improve revenue mobilisation to fund public goods and services essential for sustainable development.

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MERGERS AND ACQUISITIONS

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- 22.1 Learning outcomes
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22 Mergers and Acquisitions

22.0 Learning objective

The main objective of this chapter is to let readers understand mergers and acquisitions of businesses in Nigeria.

22.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

- (a) understand the concept of mergers and acquisitions;
- (b) explain the regulatory landscape of mergers and acquisition in Nigeria;
- (c) understand the reporting requirements and statutory filings with the Corporate Affairs Commission (CAC) and the Securities and Exchange Commission (SEC);
- (d) know the basis periods for assessment relating to mergers and acquisitions;
- (e) understand the tax consideration for mergers and acquisitions;
- (f) know the entities involved in business re-organisation and restructuring on
- (g) specified tax concessions and conditions to be met before qualifying for such concessions and
- (h) understand the practical successful merger and acquisitions deals in Nigeria, Africa and other climes.

22.2 Concepts of mergers and acquisitions

Merger and acquisition are a form of business combination whereby two or more companies join 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.

(c) Horizontal merger

This involves a merger involving companies in the same line of business (producing similar goods or providing similar services) for example, merger of two banks (former Chartered Bank and IBTC merged to become Stanbic IBTC Bank Plc.).

(d) Vertical merger

This is 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.

(e) 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.

22.3 The regulatory landscape of mergers and acquisitions in Nigeria

The regulatory landscape of merger and acquisition (M&A) in Nigeria is governed by several laws and regulatory bodies. Here's an overview:

- a. **Federal Competition and Consumer Protection Commission (FCCPC):** The primary regulator for M&A transactions, responsible for ensuring compliance with the Federal Competition and Consumer Protection Act (FCCPA) 2018.
- b. **Securities and Exchange Commission (SEC):** Regulates M&A activities involving public companies, ensuring transparency, fairness, and investor protection.
- c. **Corporate Affairs Commission (CAC):** Regulates companies in Nigeria, including those involved in M&A transactions.
- d. **Central Bank of Nigeria (CBN) and National Insurance Commission (NAICOM):** Sector-specific regulators that impact M&A transactions in the banking and insurance industries, respectively.

22.4 The reporting requirements and statutory filings with the Corporate Affairs Commission (CAC) and Securities and Exchange Commission (SEC)

22.4.1 Corporate Affairs Commission (CAC)

The CAC requires companies to file various documents and reports, including:

- (a) **Annual returns:** Companies must file annual returns with the CAC, which include information about the company's directors, shareholders, and financial position.
- (b) **Notice of change of directors:** Companies must notify the CAC of any changes to their directors, including appointments, resignations, or removals.
- (c) **Notice of change of shareholding:** Companies must notify the CAC of any changes to their shareholding structure.

22.4.2 Securities and exchange commission (SEC)

The SEC requires publicly traded companies to file various reports, including:

- (a) **Annual reports:** Publicly traded companies must file annual reports with the SEC, which include audited financial statements and other relevant information.
- (b) **Quarterly reports:** Publicly traded companies must file quarterly reports with the SEC, which provide updates on their financial performance and other relevant information.
- (c) **Material events:** Publicly traded companies must disclose material events, such as mergers and acquisitions, changes in management, or other significant developments.

22.5 Advise on the basis periods for assessment relating to mergers and acquisitions

The Finance Act, 2021 provides guidelines for taxing entities that engage in mergers and acquisitions.

Here are the key points to consider for tax assessment periods:

Basis periods for assessment

- (a) **Pre-acquisition period:** The period before the merger or acquisition, used to determine tax liabilities, including capital gains tax (CGT) on assets disposed of before the acquisition.
- (b) **Acquisition date:** The date of the merger or acquisition, which determines CGT on shares or assets disposed of on the acquisition date, and Stamp Duty on documents effecting the transfer of shares or assets.
- (c) **Post-acquisition period:** The period after the merger or acquisition, used to assess tax on profits earned by the combined entity.

22.6 Tax consideration for mergers and acquisitions

The tax implications of amalgamation, absorption and takeovers, depend on the arrangement effected by the companies and the result of such arrangement. The common possibilities are as follows:

(a) **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 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.
- (b) **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 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 merger.
 - (iv) Fees payable for professional services in connection with the merger or consolidation will be subject to VAT and WHT.
 - (vi) Any increase in share capital as a result of a merger will attract payment of stamp duties.

(c) 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; and
- (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.

(d) Trade or business sold or transferred: Section 29 (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:

- (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.

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.

(e) 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:

- (i) the commencement and cessation provisions shall not apply to the reconstituted company;
- (ii) 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;

- (iii) 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;
- (iv) 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
- (v) 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.

Based on the Finance Act 2023, here are the key points to consider for tax assessment periods:

- a) **Pre-acquisition period:** The period before the merger or acquisition, used to determine tax liabilities, including Capital Gains Tax (CGT) on assets disposed of before the acquisition.
- b) **Acquisition date:** The date of the merger or acquisition, which determines CGT on shares or assets disposed of on the acquisition date, and Stamp Duty on documents effecting the transfer of shares or assets.
- c) **Post-acquisition period:** The period after the merger or acquisition, used to assess tax on profits earned by the combined entity.

Tax Implications

- a) **Capital gains tax (CGT):** CGT is applicable on gains arising from the disposal of assets, including digital assets, at 10%.
- b) **Rollover relief:** Capital gains on shares can be deferred if the sales proceeds are reinvested in a Nigerian company within the same year of assessment.
- c) **Tertiary education tax (TET):** TET is applicable and the rate with effect from 2023 is 3% of assessable profits.

22.7 Advise on entities involved in business re-organisation and restructuring

Where there is business re-organisation and restructuring (i.e. sale or transfer) among entities that are related, the following tax concessions are applicable:

- (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 allowances 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.

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:

- (a) 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;
- (b) no disposal of assets post restructuring until after one year; and
- (c) flouting of this provision will lead to a revocation of the exemption.

22.8 Practical successful mergers and acquisitions in Nigeria, African and other climes

22.8.1 Mergers and Acquisitions in Nigeria

The year 1982 was a landmark year in the history of mergers and acquisitions in Nigeria. Prior to 1982 the concept of mergers and acquisitions had minimal actual significance in Nigeria. One of the very few major mergers that took place before that time was the amalgamation of three companies- Re Bendel Co Ltd, Bendel Intra-city Bus Service Ltd and Trans-Kalife Ltd- to form the Bendel Transport Service Ltd. This situation changed significantly after the Securities and Exchange Commission (SEC) began its operations in 1982, marking the beginning of regulated business combinations in Nigeria.

The first merger attempt was in 1982 between United Nigeria Insurance Company Limited and United Life Insurance Company Limited, which was, however, not consummated. Between 1982 and 1988, The Securities and Exchange Commission supervised thirteen mergers including the mergers of Lever Brothers Nigeria Limited and Lipton Nigeria Ltd, SCOA Nigeria Ltd and Nigeria Automotive Components Ltd, John Holt Ltd and John Holt Investment Ltd- only two of which were unsuccessful.

The prospects of mergers and acquisitions in Nigeria have continued to evolve since then. Different legislations have been passed to regulate business combinations, including the Companies and Allied Matters Act of 1990 and the Investment and Securities Act of 2007, as well as some sector-specific Acts, such as the Banking and other Financial Institutions Act of 1991, the Insurance Act of 2003 and the Electric Power Sector Reform Act of 2005. In 2002, there was a merger of two important petroleum companies: Agip Nigeria Plc and Unipetrol Plc to form Oando Plc.

One of the biggest M&A transactions in Nigeria is the merger between Access Bank and Diamond Bank. The deal was strategic as it consolidated Access Bank's position as a tier one bank with a strong capital base. The merger has contributed to a healthy competition between the new entity and other existing banks and helped strengthen the Nigeria banking system.

Another which occurred in 2012 was the acquisition of Conoco Phillips by Oando Plc through its subsidiary Oando Energy Resources in a transaction worth over \$1.5 billion. Skye bank Plc also acquired Mainstreet Bank limited from the Asset Management Corporation of Nigeria (AMCON) for N120 billion.

In the ICT sector, MTN Nigeria Limited acquired VGC Communications Limited in 2008 to form a new entity MTN Nigeria Limited. In 2011, Visafone also acquired 100 % shares (N2.7 billion) in Cellcom Communications Limited.

In the oil production sector, notable mergers that have happened in Nigeria include the merger between Niger Delta Exploration & Production Plc and Niger Delta Petroleum Resources to form a new entity called Niger Delta Exploration & Production Plc, and the acquisition of Elf Nigeria Limited by Total Nigeria in 2001. The shareholders of Elf Nigeria Limited surrendered their shares for an appropriate number in Total Nigeria Plc. One other very notable acquisition transaction was Prudent Energy and Services Limited's acquisition of 75% majority stake of Forte Oil Plc in 2019.

In the manufacturing sector, two notable mergers that have happened in Nigeria include; The merger between Tower Aluminium (Nigeria) Plc & Cook N Lite (Nigeria) Plc to form the new entity Tower Aluminium Nigeria Plc, the acquisition of 50% equity holdings in Nigeria Eagle Flour mills Limited by Flour Mills of Nigeria Plc in 2010, and GlaxoSmithKline's (GSK) \$2.1 billion sale of its nutritional drink brands Lucozade and Ribena to Suntory Beverage & Food Limited in 2013.

Other popular merger and acquisition transactions include Coca-Cola's acquisition of Chi limited. Coca Cola's reason for acquiring was because they were very optimistic about Africa's consumer opportunity. Mansard Insurance Plc also acquired 60 percent equity stake of Penman Pension Limited in 2015.

22.8.2 Successful mergers and acquisitions deals in Africa

Africa has seen significant merger and acquisition activity in recent years, driven by factors such as economic growth, industry consolidation, and foreign investment. Here are some notable examples:

South Africa

- (a) **Stripe's Acquisition of Paystack:** Stripe acquired Paystack, a Nigerian payment startup, for \$200 million, marking its entry into Africa.
- (b) **Visa's Minority Stake in Interswitch:** Visa acquired a minority stake in Interswitch, a Nigerian digital payments firm, boosting Interswitch's valuation to unicorn status.

22.8.3 Successful mergers and acquisitions deals in other climes

Here are some notable examples of successful merger and acquisition deals:

(a) Telecommunications

- (i) Vodafone and Mannesmann (1999): Vodafone acquired Mannesmann for \$202.8 billion, creating the world's largest mobile operator at the time.
- (ii) Verizon and Vodafone (2013): Verizon acquired Vodafone's US wireless division for \$130 billion, gaining full control over its wireless operations.
- (iii) AT&T and BellSouth (2006): AT&T acquired BellSouth for \$86 billion, expanding its presence in the telecommunications market.

(b) Energy

- (i) Exxon and Mobil (1999): Exxon acquired Mobil for \$80 billion, creating one of the world's largest publicly traded energy corporations.
- (ii) Shenhua Group and China Guodian Corporation (2017): The two companies merged for \$278 billion, creating the world's largest power utility company by installed capacity.
- (iii) Energy Transfer Equity and Energy Transfer Partners (2018): The companies merged in a deal worth \$90 billion, simplifying their corporate structure.

(c) Pharmaceuticals

- (i) Pfizer and Warner-Lambert (2000): Pfizer acquired Warner-Lambert for \$90.27 billion, expanding its product portfolio and market presence.
- (ii) Glaxo Wellcome and SmithKline Beecham (2000): The companies merged to form GlaxoSmithKline, one of the world's largest pharmaceutical firms.
- (iii) AbbVie and Allergan plc (2019): AbbVie acquired Allergan for \$63 billion, expanding its portfolio in key therapeutic areas.

(d) Technology

- (i) Microsoft and Activision Blizzard (2023): Microsoft acquired Activision Blizzard for \$75.4 billion, boosting its gaming segment across various platforms.
- (ii) Broadcom and VMWare (2023): Broadcom acquired VMWare for \$61 billion, strengthening its infrastructure software business.

22.9 Chapter review

This chapter discusses the tax concepts of mergers, and acquisitions. It was noted that the reporting requirements and statutory filings with the Corporate Affairs Commission (CAC) and the Securities and Exchange Commission (SEC) must be met before any merger, transfer or restructuring of a trade or business carried on by a company, can take place. Tax implications of successful merger and acquisition deals were also covered.

22.10 Worked examples

22.10.1 Questions

Aseye & Co (Tax Consultants)

In its bid to increase market power, growth and enhanced operating economies, the Board of Directors of a medium-sized beverage outfit, Yemmysea Beverages Limited, Abeokuta, considered the proposals on merger or acquisition with a business entity in the same line of business. The Chairman of the Board found all the proposals attractive.

The Financial Accountant, however, submitted that the Board needs to take into consideration tax implications on each of the merger or acquisition arrangements tabled before it. A reputable tax consulting outfit, with vast tax experience in merger, acquisition and re-organisation was recommended for this assignment.

Your firm has just been approached to offer professional advice on tax implications on each of the following merger or acquisition arrangements:

Proposal 1: When an existing company absorbs another existing company;

Proposal 2: When merger results in the cessation of business; and

Proposal 3: When a business is sold or transferred.

Required:

As the company's Tax Consultant, you are to submit a report to the Managing Director explaining:

- a) The tax implications when an existing company absorbs another existing company
- b) The tax implications when merger results in the cessation of business
- c) The tax implications when a business is sold or transferred
- d) The powers of the Federal Inland Revenue Service on issues that concern mergers and acquisition of companies

2. PQR Telecoms Group acquired a majority stake of PQR Telecoms Nigeria's shares. The company then expanded its operations to several African countries. It also acquired a rival business and faced challenges integrating the two entities.

Required:

- a. Discuss the key factors driving this acquisition, and how they impact the companies involved.
- b. Discuss the strategic considerations behind this expansion, and how did the company adapt to local markets.
- c. State the benefits and challenges of this acquisition, and how they impact the telecommunication sector in Africa.
- d. Explain the key considerations for the acquirer, and how it navigates the regulatory environment.

3. 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; or
- 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:

The tax implications of two companies in the same industry merging with each other, where:

- a. An entirely new company emerges from the process;
 - b. One of the merging companies survives with its old name or new name.
 - c. Where any of the merged companies ceased business operations.
 - d. 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.
4. JKY Limited is a newly incorporated company in Nigeria. After some years in operations, JKY became a publicly quoted company listed on the Nigerian Stock Exchange. JKY Plc failed to file its annual returns with the Corporate Affairs Commission (CAC) on time due to some certain reasons beyond its control.

Required:

- a. Explain the statutory filing requirements with CAC, and the documents that are needed to be filed.
- b. Discuss the reporting requirements with SEC, and the documents that are needed to be filed.
- c. Explain the penalties for non-compliance, and how the company can rectify the situation.

22.10.2 Suggested solutions to questions

1.

Aseye & Co (Tax Consultants)
Tonadey Road
Abeokuta

Date

The Managing Director
Yemmysea Beverages Limited
Abeokuta

Dear Sir,

RE: Tax Implications on Merger and Acquisition Arrangements, and Powers of Federal Inland Revenue Service

We refer to your request on the above subject matter and wish to comment as follows:

(a) The tax implications when an existing company absorbs another existing company include:

- i. the company absorbed will be deemed to have ceased business and the cessation rules will apply to it;
- ii. 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 absorption is not different from that of the company absorbed or taken over. Therefore, commencement provisions will not apply to it and tax returns will be filed as an ongoing company;
- iii. the surviving company will not be entitled to investment allowance and initial allowance on the assets transferred to it through absorption. The annual allowance will be based on the tax written down values;
- iv. the unabsorbed losses and capital allowances of the individual merging companies may not be allowed to be carried forward and set off against assessable profits of the surviving company after the merger;
- v. fees payable for professional services in connection with the merger will be subject to value added tax and withholding tax; and
- vi. any increase in share capital as a result of a merger will attract payment of stamp duties.

(b) The tax implications when merger results in the cessation of business include:

- (i) the cessation provisions will only apply to those companies which have ceased business permanently;
- (ii) any unrelieved capital allowances at cessation can be carried backward and set off against assessable profits of five years proceeding the year of cessation;

- (iii) any unrelieved losses at cessation cannot be carried backward to be set off against the assessable profits of the preceding years of assessment; and
 - (iv) 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.
- (c) The tax implications when a business is sold or transferred If a trade or business is sold or transferred to a Nigerian company together with any asset employed therein and the FIRS 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 FIRS may at its discretion direct that:
- (i) the commencement and cessation provisions are not applied;
 - (ii) for capital allowances purpose, the assets sold or transferred shall be deemed to have been sold for an amount equal to the residue of qualifying capital expenditure thereon on the day following such sale or transfer;
 - (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; and
 - (v) in order to benefit from the unutilised losses incurred in the old trade, the company acquiring the old trade may 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.
- (d) **The powers of the Federal Inland Revenue Service on issues that concern mergers and acquisition of companies include:**
- (i) the consent of the FIRS, including clearance with respect to any capital gains tax that may be due and payable must be obtained before any merger, sales, takeover, transfer, or restructuring of a business carried on by a company can take place;
 - (ii) the CITA 2004 (as amended) gave the FIRS powers to the extent that no merger can be consummated without obtaining the consent or direction of the FIRS; and
 - (iii) under CITA, no merger, takeover or transfer can take place without having obtained the FIRS's direction and clearance with respect to any tax that may be due and payable.

We hope this presentation meets your requirements. If you need any further clarification on this, please do not hesitate to contact us.

Yours faithfully

For: ASEYE & CO.

A. BODE
Managing Partner

2. (a) The acquisition was driven by PQR Telecoms Group's desire to increase its stake in the Nigerian market. The deal expanded PQR Telecoms' presence in Africa's largest economy.
- (b) The company's expansion was driven by its strategy to become a pan-African leader. The company adapted to local markets by offering products tailored to local choice and preferences.
- (c) The acquisition expanded PQR Telecoms Group's presence in the African telecommunication sector. The deal presented opportunities for growth and increased market share.
- (d) Key considerations for successful mergers and acquisitions, include:
 - i. Strategic fit: The acquisition should align with the company's overall strategy and goals.
 - ii. Due diligence: A thorough due diligence review is essential to identify potential risks and opportunities.
 - iii. Cultural integration: Integrating different corporate cultures can be challenging, but it's crucial for success.
 - iv. Regulatory compliance: Companies must comply with local regulations and laws.

3.

Ahmed Kelechi & Co. (Chartered Accountants)
13, Long Avenue, Warri, Delta State

September 10, 2024

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. Tax implications of two companies in the same industry merging with each other where an entirely new company emerges from the process:

- i. Rendition of annual returns;
- ii. Commencement provisions of the law under Section 29(3) will apply;
- iii. Claim of capital allowances on qualifying capital expenditure will be deemed to have been taken over at their tax written down values;
- iv. Unabsorbed losses and un-utilised capital allowances brought forward by the old company cannot be carried forward to the new company;
- v. 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
- vi. Any cost associated with the merger or arrangement shall not be allowed for tax purposes.

b. One of the merging companies surviving with its old name or new name

- i. Surviving company must file returns not more than 6 months after the end of the accounting year.
- ii. Commencement rules will not be applicable.
- iii. No initial allowance on assets transferred.
- iv. Claim of annual allowance on tax written down value (TWDV) of the assets inherited.
- v. Not to inherit the unabsorbed losses and unutilised capital allowance of the merger unless there is evidence that the company is reconstituted.
- vi. Professional service fees to be liable to VAT and WHT.
- vii. Stamp duties to be paid on increase in share capital.

c. Where any of the merged companies ceased business operation

- i. Cessation rule will be applicable under Section 29(4) of CITA Cap C21 LFN 2004 (as amended).
 - ii. 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).
 - 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.
 - iv. Any unrelieved loss in the year of cessation is a terminal loss.
- d. **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 (that is, 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, with its restrictions as provided for in Section 2 Finance Act, 2021 (which amended Section 30 of the Capital Gains Tax Act 2004).

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.**

B. YARO
Managing Partner

4. (a) Statutory filing requirements with CAC

- i. Annual returns: Companies must file annual returns alongside audited accounts within 42 days after the Annual General Meeting (AGM). This applies to all companies except single-shareholder companies.
- ii. Notice of accounting reference period: Companies must file a notice of change in accounting reference period or financial year-end date.

- iii. Disclosure of remuneration of managers: Public companies must disclose the remuneration of managers, defined as persons occupying senior management positions with significant autonomy and authority.
- iv. Register of directors' residential addresses: Companies must keep a register of directors' residential addresses.
- v. Minimum share capital: Companies must meet the minimum share capital requirements, which are ~~N~~100,000 for private companies and ~~N~~2,000,000 for public companies.

Documents to be filed include:

- i annual returns;
- ii financial statements;
- iii changes in company structure or directors; and
- iv other statutory documents.

(b) Statutory filing requirements with SEC

- i. Annual returns: Capital market operators must file annual returns within three months after the end of their accounting year, accompanied by audited financial statements.
- ii. Quarterly reports: Capital market operators may also be required to file quarterly reports.
- iii. Dedicated email addresses: SEC has designated specific email addresses for filing returns, including;
 - **Trustees:** trustees@sec.gov.ng;
 - **Rating agencies:** ratingagency@sec.gov.ng;
 - **Registrars:** registrars@sec.gov.ng;
 - **Issuing houses:** issuinghouse@sec.gov.ng;
 - **Custodians:** custodians@sec.gov.ng;
 - **Audited financial statements:** afs@sec.gov.ng;
- iv. Other requirements
 - Audit requirements: Companies must prepare, and sign audited financial statements, which must be done by an ICAN-registered auditor.
 - Filing fees: Companies must pay filing fees for annual returns and other documents.

Documents that are needed to be filed

- i. Quarterly financial reports
- ii. Annual financial reports
- iii. Other reports as required by SEC

(c) Penalties for non-compliance with CAC and SEC and how the companies can rectify the situation

Penalties for non-compliance with CAC

- i. Late filing fees: Companies that fail to file annual returns on time may be charged late filing fees, which can range from ~~N~~5,000 to ~~N~~50,000 or more, depending on the company type and duration of delinquency.
- ii. Penalties for inaccurate information: Providing false or inaccurate information can lead to penalties, fines, or even prosecution.
- iii. Striking off: In severe cases, the CAC may strike off the company from the register, effectively dissolving it.

How the company can rectify the situation.

- i. File overdue returns: Companies can file overdue returns and pay the required late filing fees.
- ii. Apply for restoration: If a company has been struck off, it can apply for restoration to the CAC.
- iii. Regularise records: Companies should ensure their records are up-to-date and accurate to avoid future non-compliance.

Penalties for Non-Compliance with SEC

- i. Fines: Capital market operators that fail to file returns or comply with SEC regulations may face fines, which can range from ~~N~~50,000 to ~~N~~500,000 or more.
- ii. Suspension or revocation of license: SEC may suspend or revoke the license of a capital market operator that fails to comply with regulations.
- iii. Other sanctions: SEC may impose other sanctions, such as reprimand, warning, or censure.

How the company can rectify the situation.

- i. File overdue returns: Capital market operators can file overdue returns and pay the required fines.
- ii. Submit compliance plan: Companies can submit a compliance plan to SEC, outlining steps to rectify the situation and prevent future non-compliance.
- iii. Engage with SEC: Companies can engage with SEC to discuss their situation and negotiate a resolution.

Best Practices

- i. Maintain accurate records: Companies should maintain accurate and up-to-date records to ensure timely compliance with filing requirements.
- ii. Monitor filing deadlines: Companies should monitor filing deadlines and plan ahead to avoid late filing fees and penalties.
- iii. Seek Professional Advice: Companies can seek professional advice from lawyers, accountants, or company secretaries to ensure compliance with regulatory requirements.

TAX PRACTICE MANAGEMENT

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23 Tax Practice Management

23.0 Learning objective

The learning objective of this chapter is to appreciate the process of tax managements, relevant procedures and modern approach using available technologies.

23.1 Learning outcomes

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.

23.2 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.

23.3 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.

23.4 Client and engagement acceptance

23.4.1 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:

- a) individual taxpayers; and

- b) corporate taxpayers.

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.

23.4.2 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 1

Letter of appointment as tax consultant written on the letterhead of DDB Nigeria Ltd.

April 5, 2025

The Managing Partner
Adedeji Consultants
Mable House
Broad Street
Lagos

Dear Sir,

Re: 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, 2025, 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)
F. Atanda
Managing Director

23.4.4 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 2

Specimen letter of acceptance on the letterhead of Adedeji Consultants

April 10, 2025

The Managing Director
DDB Nigeria Limited
4, Brown Road
Surulere
Lagos.

Dear Sir,

Re: Acceptance of Offer as Tax Consultants

Your letter dated April 05, 2025, 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: Adedeji Consultants

(Signed)
Romoke Busari
Managing Partner

23.4.5 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 3

Specimen letter of introduction to Federal Inland Revenue Service on the letterhead of DDB Nigeria Ltd

April 7, 2025

The Tax Controller
Federal Inland Revenue Service
Surulere Mirco and Small Tax Office (MSTO) 5, Adeniran Ogunsanya Street
Surulere, Lagos

Dear Sir,

Re: Appointment as Tax Consultants

This is to inform you that we have appointed Adedeji 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**

cc:
The Managing Partner
Adedeji Consultants
Mable House (5th floor),
23, Broad Street Lagos.

Illustration 4

Specimen letter of introduction to Lagos State Internal Revenue Service on the letterhead of DDB Nigeria Ltd

April 10, 2025

The Head of Station
Lagos State Internal Revenue Service Surulere Tax Office
14, Bode Thomas Street Surulere, Lagos

Dear Ma,

Re: Appointment as Tax Consultants

This is to inform you that we have appointed Adedeji Consultants 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)
F. Atanda

Managing Director

cc:
The Managing Partner
Adedeji 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.

23.4.6 Client and engagement acceptance – (Communication with tax authorities)

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:

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.

VAT registration

A taxable 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.

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; and
- d. evidence of payment of self-assessment tax computation

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 tax returns.

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.

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 5

Bamiji Limited, Ibadan 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 December 31, 2023 could not be signed by the directors until August 1, 2024, 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 July 30, 2024. The tax consultant filed and paid for self-assessment on August 2, 2024 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.

Solution to illustration 5

August 8, 2024

The Tax Controller

Federal Inland Revenue Service Integrated Tax Office

Minna Way,

Ibadan

Dear Sir,

Bamiji Limited

TIN NO: 21494422 – 0001

Objection to BOJ Assessment No YC/A/110/2018/1 dated July 30, 2024 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, Bamiji Limited for 2024 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 2024 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 August 2, 2024. 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

Tolu Ojo

For: Managing Partner

CC:

The Managing Director Bamiji Limited
4, UI Road
Ibadan

23.4.7 Tax queries and replies to queries

Tax queries emanate from desk examinations of tax returns by tax officials. Returns are examined, supporting documents are requested for 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, to eliminate any private or capital expenditure from the tax returns and 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.

23.4.8 Client and engagement acceptance – (Communication with other stakeholders) Communication with other stakeholders is specifically required to gather additional information on the clients' business.

23.4.9 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.

23.4.10 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.

23.4.11 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.

23.4.12 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;

Financial matters:

- a) Signed audited financial statements
- b) Books of account, ledgers, trial balance (hard & softcopies)
- c) Fixed assets register and title documents
- d) Accounts and procedural manual
- e) Payment vouchers, receipts, etc.
- f) Banking & cash transaction documents
- g) Monthly payroll and directors' emolument
- h) Correspondence with tax authorities and other third parties
- i) 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.

23.4.13 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.

23.5 Risks and benefits of running a professional tax practice

23.5.1 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:

a. 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.

b. 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.

c. 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).

d. 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 workday, owner's brain is typically plugged into business.

23.5.2 Benefits of running a professional tax practice

The following are some of the benefits of running a professional tax practice:

a) 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.

b) 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.

c) 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 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.

d) 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.

e) 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.

23.6 Risk mitigation strategies in tax practice

Tax practitioners in Nigeria face various risks, including compliance risks, reputational risks, and operational risks. Here are some risk mitigation strategies:

- a) regularly review and update knowledge of Nigerian tax laws, regulations, and guidelines to ensure compliance;
- b) identify potential tax risks and assess their likelihood and impact on clients or the organisation;
- c) establish and maintain effective compliance procedures, including record-keeping, reporting, and documentation;
- d) ensure accurate and complete records of tax-related documents, including returns, payments, and correspondence;
- e) provide regular training and education to staff and clients on tax laws, regulations, and best practices;
- f) monitor and address interactions with tax authorities, including audits, inspections, and disputes;
- g) develop and implement tax risk management policies and procedures to guide decision-making and ensure consistency;
- h) engage with tax professionals and experts to seek guidance and advice on complex tax issues;
- i) utilise technology and automation to streamline tax processes, improve accuracy, and reduce errors;
- j) regularly review and update tax strategies to ensure they remain effective and compliant with changing tax laws and regulations;
- k) only take on work within your circle of competence;
- l) 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;
- m) Implement quality control systems in professional tax practice; and
- n) quality control systems can not only help you avoid common pitfalls and manage risk, but they can also help you improve your practice effectiveness.

Other ideas to mitigate the risks

- a) **Use checklists:** A best practice for the practice is to create general tax preparation and review checklists for all your staff to use.
- b) **Implementation of a task and deadline tracking system:** A task tracking system can help tax practitioner monitor client filings and meet their due dates.
- c) **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.
- d) **Invest in education:** The Nigerian tax system is becoming complex and constantly changing, so the practice should continually invest in staff training.
- e) **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.
- f) **Obtain professional valuations:** When related parties transact with each other in significant transactions including reorganisations, 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.
- g) **Maintain a strong professional network,** including relationships with other tax practitioners, experts, and industry associations.
- h) **Stay informed about industry developments,** including changes in tax laws, regulations, and best practices.
- i) **Participate in professional development opportunities,** including training, conferences, and workshops.
- j) **Consider professional indemnity insurance to protect against potential claims and liabilities.**

23.7 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).

The Finance Act, 2019, has amended sections 57 and 58 of PITA 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.

23.8 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 paradigm that has been adopted by enterprise organisations 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 practices are 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.

Modern tax technology can 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.

- iii. 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.

23.9 Challenges of using available digital technology solution for tax compliance

The challenges include the following:

- a) Infrastructure and connectivity issues: Poor internet connectivity, limited access to computers or mobile devices, and frequent power outages can hinder the effectiveness of digital tax solutions.
- b) Cybersecurity concerns: Taxpayers may be hesitant to share personal financial information online due to concerns about data security and the risk of cyber-attacks.
- c) Digital literacy and skills gap: Some taxpayers may lack the necessary digital literacy and skills to effectively use technology solutions for tax compliance.
- d) Complexity of tax laws and regulations: Tax laws and regulations can be complex and difficult to navigate, making it challenging for taxpayers to ensure compliance.
- e) Cost and affordability: Some technology solutions may be costly, making them inaccessible to small businesses or individuals with limited financial resources.
- f) Data quality and accuracy: Ensuring the accuracy and quality of data entered into tax systems can be a challenge, particularly if taxpayers are not familiar with the technology.
- g) Integration with existing systems: Integrating new technology solutions with existing systems and processes can be complex and time-consuming.
- h) User experience and accessibility: Taxpayers may experience difficulties with user experience and accessibility, particularly if the technology solution is not user-friendly or accessible.
- i) Regulatory compliance: Ensuring that technology solutions comply with relevant tax laws and regulations can be a challenge.
- j) Scalability and flexibility: Technology solutions may need to be scalable and flexible to accommodate changing tax laws and regulations, as well as increasing numbers of taxpayers.

23.10 Chapter review

In this chapter, readers must have learnt 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; and types of documents to be kept by both client and tax consultants in the course of engagement.

23.11 Worked examples

23.11.1 Questions

1. James Bond Nigeria Limited, based in Ibadan was incorporated in January 2022, as a producer of wallets and other safe keeping products. The first set of audited accounts was for the year ended December 31, 2022, 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:

- a. Bank charges
- b. Electricity expenses
- c. Hotel expenses
- d. Cost of equipment
- e. Building costs
- f. Purchase of raw materials
- g. Salaries and wages
- h. Directors' fees
- i. Business insurances
- j. Rent.

Required:

Assuming you are the Tax Controller, **write** a letter to the Tax Consultants of the company requesting for the relevant documents to support the various expenses noted above.

2. A Calabar- based textile manufacturer - Deptec Ventures Nigeria Limited - was incorporated on January 1, 2022, but commenced business on July 1, 2022.

The financial year-end of the company is December 31. 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, 2020;
- (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 February 25, 2024. 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, fully allotted 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, Kano. The company commenced operations at exactly 2 pm on Monday, May 4, 2024.

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, that is, 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 can 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
- (b) Evolving strategies for expanding the Nigerian tax net to improve tax collection from the self-employed category of taxpayers

23.11.2 Suggested solutions to questions

1. Letterhead of the Tax Office

Our reference (O/R)

Your reference (Y/R)

Date

The Tax Partner
Messrs F. J. Yaba & Co.
Tolulope Street
Molete, Ibadan.

Dear Sir,

Re: Audited Financial Statements of James Bond Nigeria Limited

For the Year Ended December 31, 2022

We refer to the tax returns filed on behalf of your client, for the year ended December 31, 2022, together with the tax computations for 2022 and 2023 years of assessments.

Having examined the accounts and the accompanying schedules, it has become 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 2022.

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. 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. OLABISI

Tax Controller

2.

XYZ &Co. (Chartered Accountants)
Plot 10, Ogoja Road, Calabar

May 1, 2025

The Tax Controller
Federal Inland Revenue Service Ibadan Medium Tax office
Calabar.

Dear Sir,

RE: Registration of Deptec Ventures Nigeria Limited for Tax Purposes

We wish to inform you that we have been appointed as the external auditors to the above-named company. 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, 2023 (18 months) and audited financial statements for year ended December 31, 2024. Also included, are the copies of the relevant tax computations for 2023 and 2024 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 – July 1, 2022;
- i. the company manufactures textiles; and
- j. the company's registered address is 2, Ikot-Ekpene Road, Calabar.

Whilst thanking you for your usual cooperation in this regard, kindly update our client's tax records accordingly.

Yours faithfully
For: BABA AFOL & Co.

A. AFOLABI
Managing Partner

cc:
The Managing Director
Deptec Ventures Nigeria Limited 12, Ikot-Ekpene Road
Calabar

3 (a) **Shehu & Company (Chartered Accountants)**
3, Rano Road, Kano

O/R: FIRS/IT/12/01

Your reference (Y/R):

Date

The Tax Controller
Federal Inland Revenue Service
Medium Tax Office
4, Ramat Road
Kano.

Dear Sir,

Re: Application for Registration of Eye Service Limited (Rc: 105449) 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 February 25, 2024;
2. the registered and business address of the company is 22C, Crossroads Lane, Kano;
3. the company is in the business of providing eye services;
4. the company commenced business on May 4, 2024;
5. the accounting year-end is December 31, each year;
6. the appointed banker is Long-Time Bank Ltd., 40, Bello Road, Kano;
7. the particulars of the shareholders are as follows:

Names		No of Shares Held
(a)	Dr. Ibrahim Dogo	700,000
(b)	Hajia Munirat Dogo	150,000
(c)	Hajia. Mariam Dogo	<u>150,000</u>
		<u>1,000,000</u>

8. the directors and their addresses are:

Name	Address
Dr. Ibrahim Dogo	- 15, Moloko Way, Kano.

Munirat Dogo - 15, Moloko Way, Kano.
Hajia Mariam Dogo - 15, Moloko Way, Kano.

9. the directors have no other directorship; and
10. the appointed auditors/tax consultant is: Shehu & Company (Chartered Accountants) 3, Rano Road, Kano.

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: SHEHU & Co.

S. Musa
Managing Partner

cc: The Managing Director, Eye Service Limited
22c, Crossroads Lane, Kano.

4.

ABC & Co. (Chartered Accountants)
11, Edith Muhammad Street, Ojodu
Lagos

Our reference (O/R)

Your reference (Y/R)

Date

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 utilisation 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 avoidant 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.

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 and education
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, 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 utilisation 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 loopholes 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.

We have commented on areas deemed necessary, nevertheless, please do not hesitate to contact the undersigned, should you require any further clarification.

Yours faithfully,

For: ABC & Co.

D. OWOEYE

Managing Partner

TAX PLANNING, AVOIDANCE AND EVASION

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24 Tax Planning, Avoidance and Evasion

24.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the basic concepts and application of tax planning, avoidance and evasion.

24.1 Learning outcome

On successful completion of this chapter, readers should be able to:

- a) understand the concept and application of tax planning;
- b) know the concept and application of tax avoidance;
- c) understand the concept and application of tax evasion;
- d) differentiate between tax avoidance and evasion;
- e) ascertain the tax implication on thin capitalisation;
- f) understand the tax implication on tax havens;
- g) ascertain the tax implication on treaty shopping;
- h) understand the tax implication on non-tax factors; and
- i) advise on tax planning activities and strategies.

24.2 Tax planning

The main taxes in Nigeria can be classified into direct and indirect taxes.

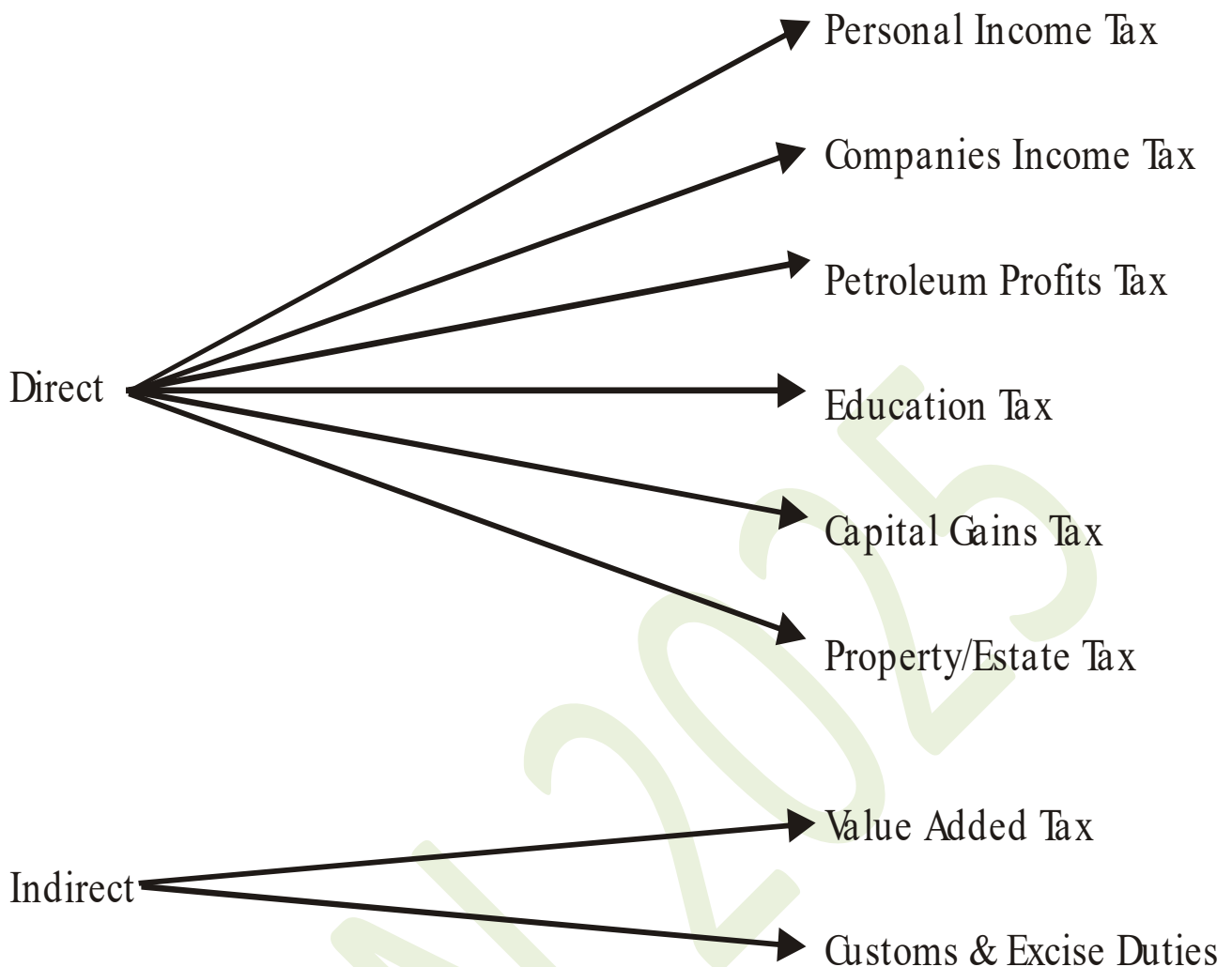
24.2.1 Direct taxes

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 (in form of hydrocarbon tax and companies income 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.

24.2.2 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 (that is, not to the tax authorities), but as part of the selling/legalization 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 is 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. It 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 minimized. 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 must 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 minimize 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 regarding 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 businessperson 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 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.

24.2.3 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); and
- (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) investment tax credit;
 - (iii) export processing zone allowance;
 - (iv) export free zone exempt profit;
 - (v) exempt profit of solid minerals mining;
 - (vi) investment tax credit – spare parts fabrication;
 - (vii) investment tax credit – replacement of obsolete plant;
 - (viii) gas industry incentives; and
 - (ix) 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; and
- (q) employees remuneration structuring; and Consider the effects of benefits in kind on taxable remuneration.

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 organize his business or trade in a legal manner to minimize 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 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 effectively 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-avoidance legislation.

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 minimizing 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:

- where there exists a pre-ordained scheme, involving a number of steps, aimed at tax avoidance; or
- 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:

- * the transaction(s) were carried out either for bona fide commercial reasons or in the ordinary course of business, and

- * 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 jeopardized 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 PIA 2021, relating to personal income 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 evasion

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:

- a) understating income,
- b) overstating expenditure,
- c) making false claims for allowances and reliefs, and
- d) 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.

24.5 Advise on tax planning activities and strategies

Tax planning is the analysis and arrangement of a person's financial situation in order to maximise 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 result, against the applicable law to find optimisation 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.

24.6 Tax avoidance and tax evasion compared

Tax evasion and tax avoidance are both ways of reducing tax burden of a taxpayer. In essence, tax evasion is illegal while tax avoidance is legal under the ambience of the law. Paying less tax or not at all than what one is legally obliged to is described as tax evasion while tax avoidance is an act of doing everything possible within the confines of the tax law to reduce the tax paid. Therefore, the main difference between them is the legality of the taxpayer’s action.

Comparison between tax avoidance and tax evasion

S/N	Tax avoidance	Tax evasion
1	Legal	Illegal

2	Achievable through exploiting loopholes in the tax laws	Achievable through deliberate action of fraud and deceit or rendering incorrect returns
3	Result in taxpayer paying minimum tax possible without breaking the law	Result in taxpayer not paying correct tax or paying minimum tax through the breaking of the tax laws
4	Supported by the courts in decided cases	No supported by the courts
5	No criminal liability	There is criminal liability
6	When stretched to the extreme, the scheme could be disregarded by the Revenue applying appropriate anti avoidance legislation	At any level, Revenue will frown at tax evasion
7	No Revenue investigation as a result of tax avoidance. Prior years assessment will not be reopened.	Revenue investigation will be instituted. Revenue has the power to open prior assessments beyond the statutory six-year limit.

24.7 Tax implication on thin capitalisation

A company is said to be thinly capitalized 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 capitalization rules generally in relation to raising and maintenance of capital. However, several 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 capitalized, 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 (for example, from connected parties). However, some countries simply disallow interest deductions above a certain level from all sources when the company is too highly geared under applicable tax regulations.

Some tax authorities limit the applicability of thin capitalization rules to corporate groups with foreign entities to avoid "tax leakage" to other jurisdictions. The United States "earnings stripping" rules are examples. 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.

24.7.1 Provisions of Finance Act, 2019 on thin capitalisation

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 are 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.

24.8 Tax Implication on tax havens

24.8.1 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 their 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.

24.8.2 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 lack of government's legal access to financial records are contributing factors.

24.8.3 Classification

Corporations, 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.
- c) 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.

24.8.4 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).

24.8.5 Methodology

At the risk of 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 utilizing 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.

24.8.6 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, standardization 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 offshore 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 unrealized 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 non-governmental 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.

24.8.7 Criticism

Tax havens have been criticized 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 criticized.

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 scrutinize some corporations' finances.

24.8.8 Executives on foreign assignment

Income tax is levied on individuals who perform employment duties in Nigeria and those residents 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 position.

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.

24.8.9 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 authorized dealer in freely convertible currency of dividend of profit.

24.9 Tax implication on 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 tackled 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.

24.10 Tax implication on 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 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 important to the success of the investment that is undertaken. Factors that affect the choice of location differs 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 bureaucratic 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 observed 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.

24.11 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 also learnt the thin capitalisation rule introduced by the Finance Act, 2019.

24.12 Worked examples

24.12.1 Questions

- (1) 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 Exchange, Securities and 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

- (2) In the evolving landscape of global and domestic finance, tax planning has emerged as a strategic imperative for individuals, businesses, and governments alike. It is not merely a tool for minimising tax liabilities but a framework for achieving financial efficiency, regulatory compliance, and long-term sustainability.

Required:

Discuss the following in respect to tax planning:

- 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

- (3) The Board of Directors of Dragbat Limited, Lagos, a medium-sized company, at its last meeting, deliberated on the company's tax related issues vis-à-vis one of its major competitors in the same line of business. The Managing Director presented the audited accounts of the two companies for the previous three years. He affirmed that their company has been paying more corporate and tertiary education taxes than their competitors, while returning lower profit before tax in each of the years under review. The board has since directed the Managing Director to do a thorough investigation on how competitors, according to the Chairman of the board, are having it easy with the tax authorities.

With the assistance of a former course-mate in the university, who works in the Finance unit of a competitor's organisation, the Managing Director was informed that the competitor was involved in tax planning and tax avoidance activities, and these have helped in reducing the company's tax liabilities over the years.

Being an engineer with sparse knowledge of accounting and taxation, the Managing Director has contacted you as the company's tax consultant to help explain some fundamental issues in tax planning and tax avoidance. To help you in carrying out this assignment, the Managing Director of Dragbat Limited provided you with the audited financial statements of the two competing companies for the last three years. He also informed you that the major difference between the two companies is simply that their organisation is servicing a loan facility of N120 million obtained five years ago and the company is not finding it comfortable in implementing the terms of the loan, despite its increased profitability over the last three years.

As the board will be meeting in a fortnight to consider the report on the preliminary investigation carried out, the Managing Director expects you to submit your report to him next week.

Required:

As the company's tax consultant, you are expected **to address and advise** on the following issues in your report:

- a) The concepts of tax planning, tax avoidance and thin capitalisation
 - b) Tax planning activities and strategies
 - c) Tax implications on companies that practice tax planning, tax avoidance and thin capitalisation
- (4) 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. As a result of accepting the offer he is contemplating whether to change his accounting date in 2023 from September to either March or June.

The following details relating to Malami Enterprises are made available.

	N
Adjusted profit for year ended September 30, 2021	2,000,000
Adjusted profit for year ended September 30, 2022	2,400,000
Adjusted profit for year ended September 30, 2023	3,600,000
Adjusted profit for year ended September 30, 2024	1,600,000

Required:

Advise the proprietor of Malami Enterprises on whether to change his accounting date to March 31 or June 30.

Support your answer with relevant computations.

- (5) Tax planning is a right that taxpayers must exercise to reduce tax liability and improve profitability while fully complying with existing tax legislations to avoid penalties and further risks. Thin capitalisation and non-tax factors are important fiscal policy issues which corporate players and governments in different tax jurisdictions should not undermine.

Required:

- a) Explain the concept of “thin capitalisation” and the problems it may create to both creditors and tax authorities.
- b) Discuss the thin capitalisation rules put in place by the Federal Government via the provisions of the Finance Act 2019.
- c) Explain **SIX** important non-tax factors, which may affect the choice of location of a corporate entity by a holding company in another tax jurisdiction.

24.12.2 Suggested solutions to questions

1. 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:

- (i) 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;
- (ii) 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;
- (iii) 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:

- find out the tax status of the company to be acquired. Have all returns been filed? Have all the taxes been paid?
- check outstanding tax queries and determine the tax implications of any of them;
- confirm that tax audit has been carried out on the acquired company;
- obtain copy of the Company's Tax Clearance Certificate;
- ascertain all outstanding issues on VAT and resolve same;
- ensure that capital gains tax on any asset disposal are paid to the relevant tax authority;
- check withholding tax files for outstanding issues and resolve same;
- 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;
- cessation rules will not apply to the acquired company as it is deemed to be continuing in business;
- no initial allowance will be granted on the assets; and
- 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. if you require further clarifications, please do not hesitate to contact us.

Thank you.

Yours faithfully,

For: A-Z CONSULTANTS

J. OYETAYO

Managing Partner

2. 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 minimize 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 minimize the tax liability of the employees reduces the basic salaries and any other monetized 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
	₦'000	₦'000
Principal	3,200	3,200
Interest rate	X 0.2	X 0.185
Interest	640	592
Less: Withholding tax at 10%	64	NIL
Net income	576	592

Income savings resulting from taking the option of treasury bill is:

$$\text{₦}592,000 - \text{₦}576,000 = \text{₦}16,000$$

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.

3.

**Sunny & Co. (Tax Consultants)
Success Avenue, Lagos**

October 24, 2024

The Managing Director
Dragbat Limited
Independence Road
Lagos.

Dear Sir,

RE: Advice on Tax Planning, Tax Avoidance and Thin Capitalisation

We refer you to our discussion in your office requesting us to address and provide advice on the above subject. We have since concluded the assignment and our comments are as follows:

a) Concepts of tax planning, tax avoidance and thin capitalisation

i) Tax planning

- This is the analysis and arrangement of a taxpayer's financial situation to maximise allowances and tax reliefs and minimise tax liabilities in a legal and efficient manner.
- It involves anticipating a set of circumstances and the identification of opportunities to minimise or defer tax liabilities within the law.
- Tax rules can be complicated, but taking some time to know and use them for one's benefit can change how much one ends up paying as tax.

ii) Tax avoidance

- This 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 or organisation 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 to avoid or minimise tax.
- To a very large extent, tax avoidance is legal once it is done within the limits permissible by the tax laws.

iii) 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. It shows that the company's gearing or leverage is too high.
- A thinly capitalised company is perceived to create problems for two classes of people. These are:
 - ❖ Creditors: They bear the solvency risk of the company, which must repay the bulk of its capital with interest; and
 - ❖ Tax authorities: They are concerned about abuse by excessive interest deduction, which at the end of the day, will lead to loss of tax income to the tax authorities/government.
- Following from the review carried out by us on your financial statements, your company is headed towards thin capitalisation. We advise that the terms of the loan should be restructured in such a way that annual interest payment will be less and the principal sum spread over long period. In such a way, more money hitherto spent in paying the loan will be freed and used for other ventures that will have positive effect on the company's profitability.

b) Tax planning activities and strategies

The following are known tax planning activities and strategies:

- i) there are always tax planning opportunities for companies regardless of their sizes or the jurisdictions they work in;
- ii) 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 optimisation opportunities;

- iii) in addition to local planning strategies, multinational enterprises 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;
- iv) with a sound corporate tax planning process, companies can reflect their requirements to comply with local legislation in countries they operate;
- v) tax planning is a right that taxpayers, including your company, must exercise to reduce tax liability and improve profitability while fully complying with the extant legislation to avoid penalties and further risks; and
- vi) as a matter of urgency, your company should engage an experienced and trusted tax planning strategist/ consultant to receive sound advice and guidance so as to make informed decisions on how to protect the company. Perhaps, this may be the cutting hedge your competitor is using over the years to pay lesser tax liabilities.

c) Tax implications on companies that practise tax planning, tax avoidance and thin capitalisation are:

- i) there is no offence in practising tax planning so far it is not done to the limit. If properly implemented, planning could result in significant financial advantage to a business concern as lower tax liability will be paid;
- ii) however, if it is practiced to the limit, the tax authorities can disregard such transactions and appropriate tax liability paid by the taxpayer;
- iii) on tax avoidance, this is also supported by tax laws and is legal as the taxpayer only exploited loopholes in the tax legislation to pay reduced/lower tax liability;
- iv) when tax avoidance schemes are stretched to the limit, transactions would be seen only in mere form and lacking in substance. When this signal is present, the Revenue Service would want to step in to disallow such transactions;
- v) 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(s);
- vi) for companies having thin capitalisation issues, the profit as well as tax liabilities will be significantly affected negatively; and
- vii) the Revenue Service will pay more attention to the interest payment. When it is above a particular threshold in a year (such as 30% of earnings before interest, taxes, depreciation and amortisation, on loans

by a foreign connected person, Finance Act 2019), such is considered as excess interest and recognised as a disallowable deduction in that year.

If you require further clarifications on issues raised above, please do not hesitate to contact us.

Your faithfully,
For: SUNNY & Co.

S. KAJOL
Principal Partner

4. Our reference (O/R)

Your reference (Y/R)

March 10, 2025

The Proprietor
Malami Enterprises
Lagos.

Dear Sir,

Re: Advice on Appropriate Date of Cessation

We refer to the meeting held with your good self in respect of the above subject matter and wish to comment as follows:

We advise that on change of accounting date, the tax authority has the right to assess the business either on new accounting date or on old accounting date. In practice, the tax authority will choose the higher of the two. The assessable profits for the three relevant years, which constitute the year of change and the two subsequent years shall be considered.

From the computations attached, the profits from the new accounting dates March and June are higher than that of the old date September. The tax authority would not use the old date September but the new date where the taxpayer is at liberty to choose either March or June.

We, therefore, advise that either June should be chosen as the new accounting date so as to reduce the business tax liability

Thank you.

Yours faithfully,
For: XYZ ASSOCIATES LIMITED

F. UMORU
Managing Consultant

Workings

Computations of assessable profits for the relevant years using the old accounting date (September):

		₦
2023	01/10/2021 - 30/09/2022	2,400,000
2024	01/10/2022 - 30/09/2023	3,600,000
2025	01/10/2023 - 30/09/2024	<u>1,600,000</u>
		<u>7,600,000</u>

Computations of assessable profits for the relevant years using the new accounting date (March)

		₦
2023	01/04/2021 - 31/03/2022 (6/12 x ~~₦2,000,000~~ + 6/12 x ~~₦2,400,000~~)=	2,200,000
2024	01/04/2022 - 31/03/2023 (6/12 x ~~₦2,400,000~~ + 6/12 x ~~₦3,600,000~~)=	3,000,000
2025	01/04/2023 - 31/03/2024 (6/12 x ~~₦3,600,000~~ + 6/12 x ~~₦1,600,000~~)=	<u>2,600,000</u>
		<u>7,800,000</u>

Computations of assessable profits for the relevant years using the new accounting date (June)

		₦
2023	01/07/2021 - 30/06/2022 (3/12 x ~~₦2,000,000~~ + 9/12 x ~~₦2,400,000~~)=	2,300,000
2024	01/07/2022 - 30/06/2023 (3/12 x ~~₦2,400,000~~ + 9/12 x ~~₦3,600,000~~)=	3,300,000
2025	01/07/2023 - 30/06/2024 (3/12 x ~~₦3,600,000~~ + 9/12 x ~~₦1,600,000~~)=	<u>2,100,000</u>
		<u>7,700,000</u>

Summary of assessable profits

Tax Years	September	March	June
2023	2,400,000	2,200,000	2,300,000
2024	3,600,000	3,000,000	3,300,000
2025	<u>1,600,000</u>	<u>2,600,000</u>	<u>2,100,000</u>
	<u>7,600,000</u>	<u>7,800,000</u>	<u>7,700,000</u>

5.

(a) **Concept of 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, that is, its gearing, or leverage, is too high. This is perceived to create problems for two classes of people. These are the:

- i) Creditors who bear the solvency risk of the company, which has to repay the bulk of its capital with interest;
- ii) Tax authorities, who are concerned about abuse by excessive interest deductions.

(b) **Provisions of Finance Act, 2019 on thin capitalisation**

- (i) Prior to the commencement of Finance Act, 2019, there were no thin capitalisation rules in Nigeria. However, in practice, FIRS sometimes seeks to disallow interest deductions considered excessive, which in most cases are usually done arbitrarily.
- (ii) The Finance Act, 2019 now introduces a specific benchmark of thirty percent (30%) of earnings before interest, taxes, depreciation and amortisation (EBITDA) in a year as the limit for interest deduction on loans by a foreign „connected person“.
- (iii) Where there is excess interest, such is considered as a disallowable deduction in that year.
- (iv) 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.

(c) **Non-tax factors**

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 the company should be established. However, non-tax factors cannot be undermined as they are key to the success of the investment that is undertaken. The more important non-tax factors include:

- (i) economic and political stability: A tax jurisdiction that is not stable economically and politically will not attract foreign investors and will also

- lose its local investment to other tax jurisdictions with fair or stable economy;
- (ii) adequate physical, business, accounting and legal infrastructure: Availability of infrastructures that support business, accounting, and legal operation in a country is an encouraging factor usually considered by some entities in citing a fixed base in a country;
 - (iii) the absence (or limited presence) of bureaucratic obstacles: Little or no bureaucratic bottlenecks give confidence to investors in locating their business entities in a tax jurisdiction;
 - (iv) Adequate communication channels: Availability of information source, reliable medium of communication, security of information and adequate communication channels play vital role in affecting the choice of an entity in citing its holding company in a country;
 - (v) The availability of an adequate dispute resolution mechanism: A tax jurisdiction with an independent and effective dispute resolution process and procedures is often considered ahead of countries without such process in citing of business entity and holding company;
 - (vi) Effective banking system: A country with a standard and reliable system of banking operation and financial sector shall be deemed suitable for facilitating financial transactions if the holding company or branch of the entity is present in such tax jurisdiction;
 - (vii) Ability to repatriate profit freely;
 - (viii) 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;
 - (ix) 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;
 - (x) Alternative dispute resolution as a legal process is normally an expedient and cheap alternative to the often-lengthy legal processes. Where available, it should also 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;
 - (xi) 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);
 - (xii) 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; and
 - (xiii) 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.

ICAN 2025

TAX AUDIT AND TAX INVESTIGATION

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25 Tax Audit and Tax Investigation

25.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the concepts and application of tax audit and investigation.

25.1 Learning outcomes

On successful completion of this chapter, readers should be able to:

- a) differentiate 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.

25.2 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 an organisation is providing 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, 2020 (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 objectives that are to be achieved as set out in the auditor's terms of reference.

25.3 Tax Audit

Tax audit is a process of carefully assessing tax returns filed by taxpayers in accordance with the provisions of the relevant applicable tax laws. The assessment must establish that the taxpayer has correctly reported all tax liabilities. The tax audit process entails an examination of tax returns, accounting records, and other financial documents by a tax authority, with the broad goal of verifying the accuracy of a company's tax payments.

Tax audit is a routine exercise, and the outcome usually leads to reassessment or referral for special investigation, if tax evasion is suspected. 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. The thrust of a tax audit will be that of verification of the figures and other information submitted by the taxpayer for tax purposes.

25.3.1 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.

25.3.2 Objectives of Tax Audit

The objectives are to enable the tax auditors determine whether:

- 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.
- d) provision of an avenue to educate taxpayers on various provisions of the tax law;
- e) discourage tax evasion;
- f) detect and correct accounting and/or arithmetical errors in tax returns;
- g) provide feedback to the management on various provisions of the law and recommend possible changes;

- h) identify cases involving tax fraud and recommend them for investigation;
- i) forestall taxable persons' failure to render tax returns;
- j) forestall taxable persons rendering incomplete or inaccurate returns; and
- k) to encourage voluntary compliance that is one of the strong reasons in support of the self-assessment scheme. It is usually conducted by a group of experienced personnel of the Revenue Authority.

25.4 Types of tax audit

The two types of tax audit are:

- (a) Desk audit;
- (b) Field audit.

25.4.1 Desk review/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.

25.4.2 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 obtain appropriate information directly from the officials of the business.

25.5 Stages involved in tax audit

The stages involved in field tax audit are as follows:

- i. selection of taxpayer to be audited;
- ii. preliminary review of taxpayer's file;
- iii. notification of taxpayer;
- iv. pre-audit meeting followed immediately by field audit;
- v. actual field audit;
- vi. post-audit meeting;
- vii. interim audit report;
- viii. post audit review by Regional/Headquarters Audit;
- ix. reconciliation meetings; and
- x. 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 tax payers;

- (o) random sampling;
- (p) firms making unusual requests or taking extraordinary decisions such as centralising an erstwhile decentralised 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 includes, 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 (authorised 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 year end.

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

This is also known as the planning stage. It involves the selection of taxpayers, notifying taxpayers of the tax audit exercise and selection of the tax audit teams among others. The features of pre-audit are as follows:

- (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 therefrom.
 - (v) giving the taxpayers the opportunity to express their views on the audit.
 - Seeking the cooperation of the taxpayer in terms of providing books and records, and explanation where necessary.
 - The team leader is expected to chair the meeting while a member of the audit team is expected to take minutes of the meeting.
- (c) 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

This is the beginning of the tax audit cycle; it is usually carried out in the taxpayers' premises on an earlier agreed date. It includes service of the assessments and demand notices on the taxpayer which usually signify the end of the audit cycle.

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. This begins after the end of the audit cycle, it basically involves payments, objections, appeals by taxpayers and other activities relating to the collection and appeal procedure.

25.5.7 Interim audit reports

Preliminary reports: Sometimes, the scheduled officer of a case, would come across material issues, during 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 taxpayer 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 analyzed 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 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.

25.7 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 the various 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.

25.8 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 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.

25.9 Tax investigation

Tax investigation is an extensive inquiry by the Relevant Tax Authority to recover undercharged taxes from previous years of assessment. It is usually carried out on reasonable suspicion of fraud, evasion or wilful default; and sometimes by random sampling. A tax investigation can also be viewed as a thorough examination by tax authorities to identify the potential for non-compliance or tax evasion by taxpayers. Whether prompted by specific intelligence, suspicion, or random sampling, these inquiries deep-dive into financial transactions and records to verify that taxes are correctly reported and paid.

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.

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 following:

- 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.

25.10 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:

- i) informing the taxpayer of the purpose of the investigation;
- ii) confirming background information of the taxpayer earlier obtained in the surveillance or pre-investigation activities assessment file;
- iii) familiarisation with the company's accounting and operational systems;
- iv) giving the taxpayers opportunity to express their views on the investigation; and
- v) 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 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.

25.11 Investigation/intelligence departments

The Investigation/Intelligence Department of the Federal Inland Revenue Service (FIRS) oversees 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.

25.11.1 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;
 - iii. 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;
 - iv. back to back loans (for example, to avoid Withholding Tax (WHT) or enjoy lower treaty rate);
 - v. alleged purchase of foreign assets at inflated amounts, which results in excess capital allowances claim;

- vi. the use of tax havens and its detrimental impact on the tax system could be significant, both in terms of revenue and compliance; and
- vii. 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; and
- f) identify areas of amendments to tax laws in order to plug all areas of tax leakages.

25.11.2 Criminal investigation unit

- a) The criminal investigation unit is responsible to investigate, penalize 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 onshore 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.

25.11.3 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.

25.12 Assessment of investigation/intelligence departments

The perceived strengths and weaknesses of the Investigation/ Intelligence Department are:

Strengths

- a) Top management support

- b) Quality staffing with officers of high integrity and professional competence, mostly chartered accountants, economists and lawyers
- c) Enforcement powers in the tax laws such as power to issue warrants after due consultation with the management in the case of resistance
- d) FIRS legal unit's continued assistance in the prosecution of tax offenders and advising on legal issues.

Weaknesses:

- a) Internal and external interference
- b) Obstruction of investigation through abuse of the judicial process
- c) Conflicts between Tax Audit Section in tax offices and Civil Investigation Unit
- d) Delays through lack of cooperation from taxpayers in the provision of necessary documents and records
- e) Inadequate funding due to budgetary constraints
- f) Inadequate experience in criminal investigation
- g) Reliance on external bodies such as the Nigerian Police, Economic and Financial Crimes Commission, etc
- h) Inadequate Infrastructure - computers and equipment to perform necessary duties and unstable power supply

25.13 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 authorities. The approach and scope of work would be slightly different from that to be carried out for audit under CAMA 2020 (as amended).

25.13.1 Provisions of tax laws

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 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 default 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.

Part VI, Sections 277-287 of Petroleum Industry Act, 2021

These relevant sections of the Act grant powers to the FIRS to request from oil and gas companies operating in Nigeria:

- (i) delivery of accounts and particulars;
- (ii) request for further information;
- (iii) call for returns and books;
- (iv) call for returns of estimated tax;
- (v) grants extension for making returns;
- (vi) to assess the company to tax;
- (vii) to conduct additional assessments (if the situation demands);
- (viii) to give notices of assessment; and
- (ix) to treat errors and defects in assessment and notice.

The Act further grants the FIRS to conduct tax audit or investigation when infractions are noticed in respect of the above documents and payment of taxes arise.

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.

25.13.2 Power of distraint 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) distraint The taxpayer by his goods or other chattels, bonds or other securities; and
- b) distraint upon any land, premises or places in respect of which the taxpayer 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 authorized 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 taxpayer after which they may be sold in the event that the tax due is not paid;
- iv) the sales proceeds are 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 taxpayer 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.

25.13.3 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.

25.14 Differences between tax audit and tax investigation

While tax audits and investigations aim to ensure tax compliance, they vary in scope, conduct, extent, and results. The differences between tax audit and tax investigation could be summarised as follows:

- a) A tax audit's primary objective is to examine whether there is accuracy and compliance in a company's tax payments, while tax investigation's primary objective

is to determine whether tax violations have occurred and recover taxes underpaid in prior evaluation years.

- b) Tax audit is legally required periodically, to confirm the accuracy of the self-assessment of a taxpayer. Tax investigation is like any other form of investigation. It is not carried out on routine basis as that of a tax audit;
- c) 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;
- d) A tax audit reviews records for compliance with tax laws, while tax investigation is to investigate a taxpayer's actions initiated by suspicion of deliberate default or fraud.
- e) Tax audit's goal is to guide businesses to pay taxes accurately and timely, while tax investigation's goal is to regain undercharged taxes from prior years, which requires the identification of potential tax evasion.
- f) 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;
- g) During tax audit taxpayers typically get notified in advance, while during tax investigation taxpayers get surprise visits.
- h) 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
- i) 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.

25.15 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) Purchase 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) Evidence of input VAT claimed
- (q) Evidence 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) Inventory 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

25.16 List of required documents for tax audit and investigation exercise carried out by States Internal Revenue Service

- (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

25.17 Benefits of tax health check to tax audit and investigation

A tax health check is a review of a taxpayer's tax and accounting records to ascertain the level of compliance with relevant tax laws, quantifying the potential tax exposures (if any) and evaluating recommendations for improved compliance.

A tax health check provides an assurance that tax implications for a certain period, an area of compliance or a specific transaction are identified, duly addressed and appropriate actions for risk mitigation are taken. Conducting such health checks on a periodic basis will help in managing tax risks, ensure appropriate compliance, result in better preparedness for tax audits and strengthen tax positions.

25.17.1 Step by step guideline for conducting a tax health check

- a) **Understanding your business:** The first step in a tax health check is to understand your business and the industry it operates.
- b) **Determining the scope of work:** It is important to set the scope of work to enable you to work effectively and efficiently. For example, your scope of work could include, but is not limited to the following:
 - i) review of audited financial statements
 - ii) review all contracts/transactions for the period under review to confirm their tax implications.
 - iii) review all tax returns for compliance
 - iv) review all tax correspondence with the tax authorities.
 - v) review all tax payments and ensure all tax receipts are properly filed.
 - vi) prepare Tax Health Check Report and discuss it with key business stakeholders (management).
- c) **Set a timeline:** It is important to set a project timeline to facilitate the completion of a tax health check exercise at the appropriate time and deliver the report accordingly. A timeline should be allocated to each task.
- d) **Gather adequate data:** Ensure all data gathered are adequate, complete and free of errors.
- e) **Analyse the data:** Data is the foundation upon which this new digital tax world is being built, and the quality of the outcomes that result will depend on the quality of the data that goes in. To match what governments are doing and stay one step ahead, companies must look at the tax function thoroughly.
- f) **Identify risks and concerns:** Identify risks that could be triggered by the lack of documentation and non-compliance with the relevant tax laws.
- g) **Identify opportunities:** Perform a comprehensive review of tax reconciliation to ensure all opportunities to reduce tax liability or to obtain a refund of overpaid tax are identified.

- h) **Create your tax report:** Suggesting remedies in areas of risks and ways to ensure tax compliance.
- i) **Implement the result:** This may sound needless, but some companies delay the implementation of tax health check results till later. In most cases, a delayed implementation leads to no implementation or even sanctioned implementation when tax authorities come knocking on your doors. Thus, the implementation of results must be immediate.

25.17.2 Benefits of conducting tax health check

The benefits of conducting Tax Health Check are stated below:

- a) Establish any inherent tax risks through an in-depth and systematic review of your books of accounts.
- b) Establishing any risk of and quantifying any potential back-taxes discovered during a review.
- c) Providing advice on the mitigation and settlement of any tax liabilities including engagement with the Revenue for a favourable settlement plan.
- d) It facilitates tax planning and management.

25.18 Ethical Issues in tax administration and practice

Tax professionals must adhere to codes of conduct/ethics of their professional associations and internal codes developed by their employers. The issues of confidentiality, conflict of interest, disclosure of information in tax practice, honesty and due care should not be taken for granted.

Tax practitioners do, however, face ethical dilemmas in discharging their professional responsibilities within an increasingly competitive environment of conflicting pressures from clients (particularly, alteration of tax returns), the revenue authority, government and the wider community.

The answers to the following ethical questions would go a long way in solving tax practitioners' ethical problems:

- a) What are the major ethical issues which tax practitioners face in today's ethical environment?
- b) What is the perceived frequency of occurrence of the major ethical problems?
- c) What is the perceived level of importance of these problems?
- d) How do the ethical problems compare relative to 'frequency of occurrence' and 'level of importance'?
- e) How do tax practitioners rate the ethical climate in the tax practice arena?
- f) What opportunities exist for unethical behaviour?
- g) What is the relationship between success and unethical behaviour?
- h) How relevant is a professional code of ethics?

25.19 The role of tax practitioner on communication with clients, tax authorities and other stakeholders

Tax practitioners have the primary goal of serving the public interest as outlined in the professional Code of Conduct. The work done by a tax practitioner must be trusted by clients, stakeholders and society at large. The work done by these professionals does not only reflect on themselves individually but more importantly, on the accounting profession. Hence, International accounting organisations, such as International Federation of Accountants (IFAC), are rapidly developing codes for their members who provide tax advice.

The role of a tax practitioner is to apply the tax legislation and judicial rulings to specific transactions to determine the tax consequences to the taxpayer by ensuring tax equity and equality.

IFAC code of ethics for professionals

The International Federation of Accountants (IFAC) is a global organisation representing the accounting profession. The five fundamental principles of ethics for professionals:

- a) **Integrity:** A tax professional is expected to be straightforward and honest in all professional and business relationship. A professional shall not knowingly be associated with reports, returns, communications or other information where the professional believes that the information (a) contains a materially false or misleading statement (b) contains statement or information provided recklessly.
- b) **Objectivity:** A tax professional 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. Tax professionals should seek to advance their client's position to the extent that the tax position (advice given to clients) taken must comply with applicable professional standards, laws and regulations.
- c) **Professional competence and due care:** Professional competence is commensurate with the concept of 'due professional care'. A tax professional should not undertake professional work which they are not competent to perform unless the professional has the necessary assistance from an appropriately qualified specialist. A tax professional must comply with the principle of professional competence and due care, which requires a professional:
 - i) to attain and maintain professional knowledge and skill at the level required to ensure that a client or the employing organisation receives competent professional service, based on current tax legislations; and
 - ii) to act diligently in commensurate with professional standards.
- d) **Confidentiality:** A tax professional must comply with the principle of confidentiality which requires him/her to respect the confidentiality of information acquired as a result of professional and business relationship. A tax professional shall continue to comply with the principle of confidentiality even after the end of the relationship between the tax professional and a client or employing organisation. When

changing employment or acquiring a new client, the tax professional is entitled to use prior experience but shall not use or disclose any confidential information acquired or received as a result of professional or business relationship.

- e) **Professional behaviour:** A tax professional must comply with the principle of professional behaviour, which requires tax professional to comply with the relevant laws and regulations and avoid any conduct that the tax professional knows or should know might discredit the profession. A tax professional must not tolerate and aid or encourage tax evasion which is illegal. The tax professional must advise client not to enter any arrangement that the tax professional reasonably believes that could result in tax evasion. If the client elects to ignore the tax professional's advice, tax professional must withdraw the letter of engagement with the client.

25.20 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 assessing 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 arises 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 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:

- (a) the official number of the assessment and the year for which it was made;
- (b) the amount of tax charged by the assessment;
- (c) the amount of total profits upon which the tax was charged;
- (d) the date the notice of refusal was served;
- (e) the grounds of appeal as contained in the notice of objection; and
- (f) an address for service of any notice.

Should the Tax Appeal Tribunal refuse 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:

- (a) the objection or appeal is not made within the statutory time limit (30 days);
- (b) 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
- (c) on appeal, the assessment is determined by the tax appeal tribunal, Federal High Court or the Court of Appeal or the Supreme Court.

25.21 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 Questions

1. “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 that is usually conducted by the Revenue:

- (a) Objectives of a tax audit
- (b) Selection of taxpayers for audit

2. Tax audits are a critical component of any robust tax administration system. They serve as a mechanism for verifying the accuracy of tax returns, ensuring compliance with tax laws, and promoting voluntary compliance among taxpayers.

Required:

Identify the stages in a typical tax audit process.

3. As an experienced tax consultant, one of your clients based in Kano has approached you that it noticed that the Federal Inland Revenue Service is carrying out random tax audit of companies in Kano and wants to be prepared for such exercise, should the tax authority 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 the tax authority.

Required:

Identify the documents required for the tax audit that is usually carried out by Federal Inland Revenue Service.

4. 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 has expressed a preference to handle the existing tax issues internally, without involving external parties, and seeks clarification on whether it would be more appropriate to engage tax auditors rather than investigators

Required:

As a consultant to the company, explain the following:

- (a) (i) Tax audit
- (ii) Check list in tax audit
- (iii) Tax audit report
- (iv) Compare tax investigators with tax auditors
- (b) Discuss the stages involved in tax investigation.
- (c) Examine the factors that could lead to the termination of a tax investigation.

5. As an experienced tax consultant, one of your clients based in Lagos has approached you that it noticed that the Lagos State Internal Revenue is carrying out random tax audit of companies in Lagos and wants to be prepared for such exercise, should the tax authority 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 the tax authority.

Required:

Identify the list of documents required for the tax audit to be carried out by Lagos State Internal Revenue Service.

6. Given 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

25.22.2 Suggested solutions to questions

1(a) The objectives of a tax audit are to enable the tax auditors determine whether:

- (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 inaccurate 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 centralizing an erstwhile decentralised operation;
- (xvii) information from intelligence unit of the tax authority; and
- (xviii) directive from higher government authority.

2. Stages in tax audit process

- (a) Selection of the taxpayer to be audited
- (b) Preliminary review of the taxpayer'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
- (j) Final audit report

3. List of documents required for the tax audit that is usually carried out by Federal Inland Revenue Service

- 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) Stocks 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, as the list is not exhaustive

4(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 taxpayer 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.

(vi) **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.

(vii) **Termination of investigation**

An investigation of a criminal tax fraud or tax evasion can be terminated at any stage based on the following conditions:

(c) **The following circumstances can lead to the termination of a tax investigation**

- (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.

5. **The list of documents required for the tax audit to be carried out by Lagos State Internal Revenue Service**

- 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 AFS
- 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 TrustFund (NSITF)
- i) Schedule of local and expatriate PAYE tax paid
- j) Employment contracts of both temporary and permanent expatriate staff
- k) Letter of expatriate quota for the company
- l) Copies of monthly returns on expatriate 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 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, as the list is not exhaustive

6.

- 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, 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 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 the Act.

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.

(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.

ETHICS AND PROFESSIONALISM IN TAX MANAGEMENT

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26 Ethics and Professionalism in Tax Management

26.0 Learning objective

The learning objective of this chapter is for readers to understand the ethics and the professionalism associated with tax practice management

26.1 Learning outcomes

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.

26.2 The five fundamental principles and guidance for accountants (IESBA codes)

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.

The fundamental principles of ethics as specified by the International Ethics Standards Board for Accountants (IESBA) are:

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.

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.

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 organisation 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.

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 organisation 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.

Professional behaviour

A professional accountant shall comply with the principle of professional behaviour, 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 Possible legal and ethical issues arising from tax works undertaken

The following are the possible legal and ethical issues that could arise from tax works:

- (a) Technical competence - Failure of tax practitioners to maintain an appropriate level of professional competence by ongoing development of their knowledge and skills.
- (b) Reasonable enquiry - Failure to make reasonable enquiries where information or documentation as furnished by a client appears to be inaccurate or incomplete.
- (c) Continue to act - Continuing to act for a client in circumstances where incorrect or misleading information is not corrected by the client.
- (d) Tax avoidance - Conflicts which arise in distinguishing between legitimate tax planning/tax minimisation arrangements and tax avoidance activities/schemes.
- (e) Supervision of tax audit - Failure to carefully plan for or otherwise supervise on behalf of the client, audit activities carried out by tax authorities.
- (f) Tax loopholes - "Loophole seeking" to deliberately test the boundaries of tax law.
- (g) 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.

- (h) 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".
- (i) 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.
- (j) Misrepresentation - Misrepresenting or concealing limitations in a tax practitioner's competence or skills to perform tax services.
- (k) Personal gain - Conflicts between opportunities for personal financial gain (or other personal benefit) and proper performance of a tax practitioner's responsibilities.
- (l) Conflict of interest - Conflicts of interest that involve providing services to competing clients such that the interests of one client may be prejudiced.
- (m) Documentation - Preparing and signing a return without seeing full documentation.
- (n) Communication - Failure to communicate to clients unfavourable as well as favourable information and professional opinions.
- (o) 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.
- (p) Reporting position - Determining whether the client or the tax practitioner should make the final reporting decisions for contentious or ambiguous items.
- (q) Public responsibility - Failure to acknowledge a public responsibility to contribute to the improvement of the tax laws and their administration for example, reporting blatant tax avoidance arrangements.
- (r) Professional judgment - Carrying out a client's instructions which are inconsistent with the professional judgment of the tax practitioner. (Professional judgment).
- (s) Poaching clients - Poaching or soliciting potential clients from other practitioners/practices.
- (t) Authority - Dealing with a client's funds (for example, a tax refund cheque) without client authority;
- (u) 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.
- (v) Research - Failure to conduct adequate research on a problem as a reasonable basis for identifying issues and forming carefully considered conclusions and recommendations.
- (w) 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).
- (x) Confidentiality - Failure to ensure confidentiality regarding privileged client information.
- (y) Tax minimisation - Keeping a client informed of current tax minimisation arrangements which have no real commercial or family purpose.

26.4 Justifications for appropriate legal action for non-compliance

Appropriate action for non-compliance with the fundamental principles of ethics is supported by:

- a) 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;
- b) 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;
- c) 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 member who was partner in the said firm at the material time for the purposes of this scenario; and

- d) any failure to follow the guidance in fundamental principles or in the statements shall also be considered by the Committee of the Institute responsible for regulating the work of members and member firms.

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:

- (a) imposition of fines;
- (b) suspension from membership of the Institute for a period of time;
- (c) expulsion from membership of the Institute;
- (d) withdrawal of certificate and licence to practice;
- (e) reprimand; and
- (f) payment of costs associated with the investigations and meetings.

26.6 Designing ethical safeguards against threats from employers, clients, government agencies and other stakeholders

26.6.1 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 behaviour, 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 organisation, 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.

26.6.2 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; and
 - iii. corporate governance regulations.
- (b) Safeguards in the work environment – This includes:
 - i. leadership and transparency; and
 - ii. recruitment procedures for high caliber staff.

26.7 Non-compliance with law and Regulation (NOCLAR) principles

26.7.1 Framework as a professional accountant

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) recognised 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:

- (a) become aware (see it, but do not seek it);
- (b) obtain an understanding of the matter;
- (c) address the issue with management and those charged with governance;
- (d) communicate the matter to the entity's external auditor;

- (e) consider whether further action is needed in the public interest for example, disclosing to authorities or withdrawing from the engagement; and
- (f) documentation i.e. the matter, result of discussion with management or those charged with governance, actions taken.

26.7.3 Practical process to address tax laws violation by professional accountants in business

(a) Professional accountants other than senior professional Accountants

When an organisation has established protocols and procedures regarding how non-compliance or suspected non-compliance should be raised internally, the professional accountant is expected to consider them in determining how to handle non-compliance:

- (i) Subject to established protocols and procedures, inform an immediate superior to enable the superior to take appropriate action.
- (ii) If the PA's immediate superior appears to be involved in the matter, inform the next higher level of authority within the organisation.
- (iii) In exceptional circumstances, the PA may decide that disclosure of the matter to an appropriate authority is an appropriate course of action.
- (iv) Documentation i.e. matter, discussion, response by superior, and decision taken.

(b) 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.

- (i) Become aware (see it, but do not seek it)
- (ii) Obtain the understanding of the matter
- (iii) Address the matter
- (iv) Determine whether further action is needed
- (v) Determine whether to disclose the matter to an appropriate authority
- (vi) Documentations

26.8 Ethical issues in data privacy

The Nigerian Data Protection Act 2023 addresses critical ethical issues in data privacy, client confidentiality, and data handling. These are discussed below:

26.8.1 Data privacy

- (a) Consent: Data subjects must provide informed consent for the collection and processing of their personal data.
- (b) Purpose limitation: Personal data can only be collected and processed for specified, legitimate purposes.
- (c) Data minimisation: Only necessary personal data should be collected and processed.
- (d) Accuracy: Data controllers must ensure the accuracy and up-to-datedness of personal data.
- (e) Storage limitation: Personal data should not be stored for longer than necessary.

26.8.2 Client confidentiality

- (a) Confidentiality: Data controllers and processors must maintain the confidentiality of personal data.
- (b) Non-disclosure: Personal data should not be disclosed to unauthorised parties.
- (c) Duty of care: Data controllers and processors have a duty of care to protect personal data.

26.8.3 Data handling

- (a) Data protection by design: Data controllers and processors must implement data protection measures from the outset.
- (b) Data protection impact assessment: Assessments must be conducted for high-risk data processing activities.
- (c) Data breach notification: Data controllers must notify data subjects and the relevant authorities in case of a data breach.
- (d) Accountability: Data controllers and processors are accountable for their data handling practices.

26.8.4 Rights of data subjects

- (a) Right to access: Data subjects have the right to access their personal data.
- (b) Right to rectification: Data subjects can request the correction of inaccurate personal data.
- (c) Right to erasure: Data subjects can request the deletion of their personal data.
- (d) Right to object: Data subjects can object to the processing of their personal data.

26.8.5 Obligations of data controllers and processors

- (a) Registration: Data controllers and processors may need to register with the relevant authorities.
- (b) Data protection officer: Some data controllers and processors may need to appoint a data protection officer.
- (c) Training: Data controllers and processors should provide training on data protection to their staff.

26.8.6 Enforcement and penalties

- (a) Regulatory oversight: The Nigerian Data Protection Commission will oversee compliance with the Act.
- (b) Penalties: Non-compliance can result in fines and other penalties.

26.8.7 Framework for protecting personal data

The Nigerian Data Protection Act 2023 provides a framework for protecting personal data and promoting trust in the digital economy. Organisations must comply with the Act's provisions to avoid penalties and maintain the trust of their customers and stakeholders.

The Nigerian Data Protection Act of 2023 provides a comprehensive framework for protecting personal data, which includes:

(a) Key principles

- (i) Lawfulness, Fairness, and Transparency: Personal data must be processed with the data subject's consent and in a transparent manner.
- (ii) Purpose limitation: Data should only be collected for specified purposes and not used for other purposes without consent.
- (iii) Data minimisation: Only necessary personal data should be collected and processed.
- (iv) Storage limitation: Personal data should not be stored for longer than necessary.
- (v) Accuracy: Personal data must be accurate and up-to-date.
- (vi) Integrity and confidentiality: Data controllers and processors must ensure the security and confidentiality of personal data.
- (vii) Accountability: Data controllers and processors are responsible for demonstrating compliance with these principles.

(b) Rights of data subjects

- (i) Right to information: Data subjects have the right to know how their personal data is being processed.
- (ii) Right to access: Data subjects can request access to their personal data.
- (iii) Right to rectification: Data subjects can request correction of inaccurate personal data.
- (iv) Right to erasure: Data subjects can request deletion of their personal data.
- (v) Right to object: Data subjects can object to the processing of their personal data.
- (vi) Right to data Portability: Data subjects can request transfer of their personal data to another organisation.

(c) Obligations of data controllers and processors

- (i) Registration: Data controllers and processors of major importance must register with the Nigerian Data Protection Commission.
- (ii) Data protection officer: Data controllers and processors of major importance must appoint a Data Protection Officer.
- (iii) Data breach notification: Data controllers must notify the Commission and affected data subjects in case of a data breach within 72 hours.
- (iv) Data protection impact assessment: Data controllers and processors must conduct data protection impact assessments for high-risk data processing activities.

(d) Enforcement and penalties

- (i) Nigerian Data Protection Commission: The Commission is responsible for overseeing compliance with the Act and imposing penalties for non-compliance.
- (ii) Fines and imprisonment: Non-compliance can result in fines and imprisonment, with fines ranging from N2 million to N10 million and imprisonment terms of up to 3 years.

26.9 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. Also, readers would have known the ethical issues in data privacy.

26.10 Worked examples

26.10.1 Questions

1. Ethical standards are the cornerstone of professional integrity in accountancy. The Institute of Chartered Accountants of Nigeria (ICAN) has established a Code of Professional Conduct to guide accountants in upholding public trust, ensuring transparency, and maintaining the credibility of financial reporting. These standards are not merely aspirational—they are enforceable principles that shape the behaviour and decisions of professionals in both public and private sectors. Among the various ethical principles outlined, four stand out as fundamental: Integrity, Objectivity, Professional Competence and Due Care, and Confidentiality. Each plays a vital role in safeguarding the profession's reputation and ensuring that accountants act in the best interest of stakeholders and society at large.

Required:

- (a) Analyse and evaluate any **four** (4) 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 Professionals may face pressure to engage in aggressive tax planning, exploit legal loopholes, or even facilitate tax avoidance strategies that, while technically legal, may be ethically questionable. Moreover, conflicts of interest, confidentiality breaches, and misrepresentation of facts can compromise the credibility of both the individual and the profession. In jurisdictions like Nigeria, where regulatory oversight is evolving, the ethical conduct of tax practitioners becomes even more critical in promoting transparency, equity, and public trust.

Required:

- (a) Discuss **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 engagements.

Required:

- (a) Discuss 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 violations of tax laws are observed in the course of their engagements.
4. Ethical issues in data processing have been variously addressed by the Nigerian Data Protection Act of 2023. The Act under consideration treated some specific ethical issues ranging from privacy to handling. In addition, the framework for protecting personal data was provided.

Required:

Discuss the salient points of ethical issues in data processing and the framework for protecting personal data as contained the Data Protection Act of 2023.

26.10.2 Suggested solutions to 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 within the course of performing his work.

(b) Penalties for a member's unethical behaviour

- (i) Imposition of fines
- (ii) Membership of the Institute for a period
- (iii) Expulsion from membership of the Institute
- (iv) Withdrawal of certificate and licence to practice
- (v) Reprimand
- (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 member who was partner in the said firm at the material time for the purposes of this scenario.
- (v) Any failure to follow the guidance in fundamental principles or in the statements shall also be considered 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 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 for example, 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 (for example, 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 regarding privileged client information.
 - (xxv) Tax minimisation - 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:
- (i) become aware (see it, but do not seek it);
 - (ii) obtain an understanding of the matter;
 - (iii) address the issue with management and those charged with governance;
 - (iv) communicate the matter to the entity's external auditor;
 - (v) consider whether further action is needed in the public interest, for example, disclosing to authorities or withdrawing from the engagement; and
 - (vi) documentation, that is, 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) have 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) recognised 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.

- (b) There are steps to be taken by professional accountants (PAs) other than senior professional accountants (SPAs) when violations of tax laws are observed during their engagements.

When organisations 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:

- (i) subject to established protocols and procedures, inform an immediate superior to enable the superior to take appropriate action;
- (ii) if the PA's immediate superior appears to be involved in the matter, inform the next higher level of authority within the organisation;
- (iii) in exceptional circumstances, the PA may decide that disclosure of the matter to an appropriate authority is an appropriate course of action; and
- (iv) documentation, that is, matter, discussion, response by superior, and decision taken.

4. The salient ethical issues provided in the Nigerian Data Protection Act 2023 are as follows:

Data privacy

- (a) Consent: Data subjects must provide informed consent for the collection and processing of their personal data.
- (b) Purpose limitation: Personal data can only be collected and processed for specified, legitimate purposes.
- (c) Data minimisation: Only necessary personal data should be collected and processed.
- (d) Accuracy: Data controllers must ensure the accuracy and up-to-datedness of personal data.
- (e) Storage limitation: Personal data should not be stored for longer than necessary.

Client confidentiality

- (a) Confidentiality: Data controllers and processors must maintain the confidentiality of personal data.
- (b) Non-disclosure: Personal data should not be disclosed to unauthorised parties.
- (c) Duty of care: Data controllers and processors have a duty of care to protect personal data.

Data handling

- (a) Data protection by design: Data controllers and processors must implement data protection measures from the outset.

- (b) Data protection impact assessment: Assessments must be conducted for high-risk data processing activities.
- (c) Data breach notification: Data controllers must notify data subjects and the relevant authorities in case of a data breach.
- (d) Accountability: Data controllers and processors are accountable for their data handling practices.

Rights of data subjects

- (a) Right to access: Data subjects have the right to access their personal data.
- (b) Right to rectification: Data subjects can request the correction of inaccurate personal data.
- (c) Right to erasure: Data subjects can request the deletion of their personal data.
- (d) Right to object: Data subjects can object to the processing of their personal data.

Obligations of data controllers and processors

- (a) Registration: Data controllers and processors may need to register with the relevant authorities.
- (b) Data protection officer: Some data controllers and processors may need to appoint a data protection officer.
- (c) Training: Data controllers and processors should provide training on data protection to their staff.

Enforcement and penalties

- (a) Regulatory oversight: The Nigerian Data Protection Commission will oversee compliance with the Act.
- (b) Penalties: Non-compliance can result in fines and other penalties.

Framework for protecting personal data

The Nigerian Data Protection Act 2023 provides a framework for protecting personal data and promoting trust in the digital economy. Organisations must comply with the Act's provisions to avoid penalties and maintain the trust of their customers and stakeholders.

The Nigerian Data Protection Act of 2023 provides a comprehensive framework for protecting personal data, which includes:

(a) Key principles

- (i) Lawfulness, Fairness, and Transparency: Personal data must be processed with the data subject's consent and in a transparent manner.
- (ii) Purpose limitation: Data should only be collected for specified purposes and not used for other purposes without consent.

- (iii) Data minimisation: Only necessary personal data should be collected and processed.
- (iv) Storage limitation: Personal data should not be stored for longer than necessary.
- (v) Accuracy: Personal data must be accurate and up-to-date.
- (vi) Integrity and confidentiality: Data controllers and processors must ensure the security and confidentiality of personal data.
- (vii) Accountability: Data controllers and processors are responsible for demonstrating compliance with these principles.

(b) Rights of data subjects

- (i) Right to information: Data subjects have the right to know how their personal data is being processed.
- (ii) Right to access: Data subjects can request access to their personal data.
- (iii) Right to rectification: Data subjects can request correction of inaccurate personal data.
- (iv) Right to erasure: Data subjects can request deletion of their personal data.
- (v) Right to object: Data subjects can object to the processing of their personal data.
- (vi) Right to data Portability: Data subjects can request transfer of their personal data to another organisation.

(c) Obligations of data controllers and processors

- (i) Registration: Data controllers and processors of major importance must register with the Nigerian Data Protection Commission.
- (ii) Data protection officer: Data controllers and processors of major importance must appoint a Data Protection Officer.
- (iii) Data breach notification: Data controllers must notify the Commission and affected data subjects in case of a data breach within 72 hours.
- (iv) Data protection impact assessment: Data controllers and processors must conduct data protection impact assessments for high-risk data processing activities.

(d) Enforcement and penalties

- (i) Nigerian Data Protection Commission: The Commission is responsible for overseeing compliance with the Act and imposing penalties for non-compliance.

- (ii) Fines and imprisonment: Non-compliance can result in fines and imprisonment, with fines ranging from N2 million to N10 million and imprisonment terms of up to 3 years.

ICAN 2025

TAX ACCOUNTING AND REPORTING

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27 Tax Accounting and Reporting

27.0 Learning objective

The objective of this chapter is to enhance readers' understanding of tax accounting and reporting in Nigerian business environment.

27.1 Learning outcomes

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.

27.2 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

27.3 Posting into the tax account

(a) Provision for income tax

Entries in the tax account are posted by raising the following journals:

Dr – Statement of profit or loss

Cr - Tax account

Being provision for income tax for the year based on 30% of the total profit

(b) Provision for tertiary education tax

Dr – Statement of profit or loss

Cr - Tax account

Being provision for tertiary education tax at 3% of assessable profit

- (c) Under provision for tax in the prior year
 Dr – Statement of profit or loss
 Cr - Tax account
 Being prior year under-provision for income tax
- (d) Over provision for tax in the prior year
 Dr – Tax account
 Cr - Statement of profit or loss
 Being prior year over provision for Income tax
- (e) Cash payment of taxes
 Dr – Tax account
 Cr - Bank
 Being payment on account of outstanding income tax and education tax liabilities for
- (f) Offset of income tax with withholding tax credit notes**
 Dr - Income tax account
 Cr - Withholding tax account (receivable)
 Being set-off of withholding tax suffered at source against income tax liabilities for the year

27.4 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.

27.4.1 Computation and accounting for deferred taxes (IFRS)

Deferred tax is computed by multiplying the difference between the tax base (for example, TWDV of property, plant and equipment (PPE)) and the carrying amounts (for example, 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
 Dr - Statement of profit or loss
 Cr - Deferred tax account
 Being provision charged for deferred tax liabilities on timing differences
- (b) Provision for deferred tax assets on timing differences

Dr - Deferred tax account
 Cr – Statement of profit or loss
 Being provision charged for deferred tax assets on temporary differences

Illustration 1

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%

Assuming TWDV is N500m 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%

Assuming TWDV is N500m, 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

27.5 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.

27.6 Presentation of taxes in financial statements

The note on taxation is usually presented in the financial statements in a vertical form, as follows:

	N'000
Income tax on profit before tax	x
Tertiary education tax (3% of assessable profit)	x
Prior year's under provision for income tax	x
Deferred tax liability (charge)	<u>x</u>
Per profit or loss account	xx
Outstanding at the beginning of the year	x
Adjustment for deferred tax charge	(x)
Payments during the year	<u>(x)</u>
Per statement of financial position	<u>xx</u>

27.7 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 standardisation 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 misled 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.

27.8 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.

27.9 Worked examples

27.9.1 Questions

1. Isiaka Jimoh Limited is a company engaged in manufacturing of imirat oil. Its accounts for the year ended September 30, 2023, revealed the following results:

	₦'000
Net profit for the year after charging:	300,000
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 2023, after the above capital allowances have been considered 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 N60 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, 2018. The revaluation surplus arising from the revaluation which amounted to ₦100 million was reflected in the company's financial statements for that year.

Required:

- (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, 2024, revealed the following:

	1/1/2024	31/1/2024
	₦'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,

2021 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.

Required:

Compute the company's tax liabilities for the relevant tax year, with note to the financial statements in line with the provisions of relevant accounting standards.

4. Show the journal entries for the treatment of the following transactions:
 - a. Education tax per accounts amounted to ~~₦~~2,800,000
 - b. Income tax under-provided for by ~~₦~~500,000
 - c. ~~₦~~2,750,000 paid as part of outstanding income tax
 - d. Provision for deferred taxes liability on timing differences of ~~₦~~570,000

27.9.2 Solution to illustration question

1 (a) **Isiaka Jimoh Limited Computation of tax liabilities Assessment year 2024**

	₦'000	₦'000
Net Profit per accounts		300,000
Add:		
Depreciation		22,500
Loss on sale of plant and equipment		500
Penalties and fines		<u>200</u>
		323,200
Deduct:		
Franked investment	20,000	
Repatriated interest	<u>5,600</u>	<u>(25,600)</u>
Adjusted/assessable profit		297,600
Deduct:		
Unrelieved losses brought forward		<u>(15,000)</u>
		282,600
Capital allowances		<u>(55,000)</u>
Total profit		<u>227,600</u>

Taxes payable

Companies income tax – (₦227,600) at 30% = ₦68,280

Tertiary education tax – (₦297,600) at 3% = ₦8,928

(b)Computation of deferred tax Assessment year 2024

	2024				2023	
	N'000	N'000	N'000	N'000	N'000	N'000
Tax written down value			620			665
Less:						
Net book values		550			630	
Deduct:						
Revaluation surplus	100			100		
Less:						
Depreciation 2024						
N100m at 5% p.a.x 6yrs	(30)	(70)	(480)	(25)		
Depreciation2023						
N100m at 5% p.a. x 5 years			(25)		(75)	(555)
Timing difference			140			110

Deferred tax provision

Thereon at 30%

42 33

Additional provision for deferred tax assets for the year (N42,000 – N33,000) = N9,000

Notes to the accounts

Taxation

	N'000
Income tax based on profit for the year	68,280
Tertiary edu. Tax based on 3% of ass .profits	8,928
Deferred tax credit	<u>(9,000)</u>

Per statement of profit or loss

68,208

Unpaid taxes at the beginning of the year 52,000

Income tax based on profit for the year 68,280

Tertiary edu. taxbased on 3% of ass. Profits 8,928

Payments in the year (60,000)

Per statement of financial position

69,208

Deferred tax assets account

	N' million
Balance as at 1/10/2022	33
Additional credit/provision during the year	9
Balance as at 30/09/2023	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) Provisions for income tax

Statement of profit or loss	DR
Tax account	CR

Being provision for income tax for the year based on 30% of the total profit
- (ii) Provisions for tertiary education tax

Statement of profit or loss	DR
Tax account	CR

Being prior year under-provision for income tax
- (iii) Under provision for tax in the prior year

Tax account	DR
Statement of profit or loss	CR

Being prior year over provision for income tax
- (iv) Cash payment of taxes

Tax account	DR
Bank	CR

Being payment on account of outstanding income tax and education tax liabilities for the year
- (v) Offset of income tax 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
- (vi) Provision for deferred tax liabilities on timing differences

Statement of profit or loss	Dr
Deferred tax account	CR

Being provision charged for deferred tax liabilities on timing differences
- (vii) Provision for deferred tax assets on timing

differences
Deferred tax account DR
Statement of profit or loss CR
Being deferred tax assets provision on temporary differences

3. **Ojeaga Limited**
Computation of tax liabilities for 2025 tax year

	N' million	N' million
Net profit for the year		660
Add: Disallowable expenses		
Depreciation	17	
Stamp duties	<u>2</u>	<u>19</u>
		679
Less: Profit on sale of property	4	
Franked investment income	25	<u>29</u>
Assessable profit		650
Less: Unrelieved losses b/f		<u>10</u>
		640
Less: Capital allowances		<u>60</u>
Total profit		<u>580</u>
Companies income tax (30% of N580 million)		<u>174</u>
Tertiary education tax (3% of N650 million)		<u>19.5</u>

Computation of deferred tax for 2025 tax year

	N' million	N' 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**

	N' million
Companies income tax provision	174
Tertiary Education tax provision	19.5
Deferred tax credit	<u>(15)</u>
Charged to profit and loss accounts	<u>178.5</u>
Outstanding tax as at 1/1/2024	78
Companies income tax provision	174
Tertiary Education tax provision	<u>19.5</u>

	271.5
Outstanding tax as at 31/12/2024	<u>(63)</u>
Tax paid during the year	<u>208.5</u>

Deferred tax assets account

	N' million
Balance as at 1/1/2024	33
Additional credit/provision during the year	<u>15</u>
Balance as at 31/12/2024	<u>48</u>

Workings

1. Calculation of net book value

	2025 N' million million	2024 N' million N'
Net book value as per accounts	720	625
Less: Revaluation surplus	120	120
Depreciation	<u>(48)</u>	<u>(36)</u>
	72	
	<u>84</u>	
	<u>648</u>	<u>541</u>

2. Depreciation on revaluation surplus

2025 tax year: 10% of ~~N~~120 million x 4 = ~~N~~48million

2024 tax year: 10% of ~~N~~120 million x 3 = ~~N~~36million

- 4
- (a) Dr Profit and Loss Account ~~N~~2,800,000
Cr Provision for Education Tax Account ~~N~~2,800,000
 - (b) Dr Profit and loss Account ~~N~~500,000
Cr Provision for Income Tax Account ~~N~~500,000
 - (c) Dr Income Tax Provision Account ~~N~~2,750,000
Cr Bank ~~N~~2,750,000
 - (d) Dr Profit and loss Account ~~N~~570,000
Cr Deferred Tax Account ~~N~~570,000

OIL AND GAS TAXATION

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28 Oil and Gas Taxation

28.0 Learning objective

The objective of this chapter is to enhance readers' understanding of the operations of oil and gas taxation in Nigeria.

28.1 Learning outcomes

After studying this chapter, readers should be able to:

- (a) understand the governance and regulatory institutions in the oil and gas industry;
- (b) know the general administration, licences and leases;
- (c) know the fiscal/operating arrangements/regimes in the upstream sector;
- (d) understand the accounting period, conversion, transition and compliance; and tax implications of a company with converted and non-converted licences/leases;
- (e) identify the sources of income accruing to petroleum companies;
- (f) determine royalties based on production and price using applicable rates;
- (g) identify allowable and non-allowable expenses;
- (h) know how to compute adjusted profit;
- (i) know the treatment of losses in computations of hydrocarbon and companies income tax;
- (j) understand the treatment of unabsorbed losses and unrecouped capital allowances;
- (k) know the Income chargeable to, and exemptions from, hydrocarbon tax;
- (l) understand the treatment of qualifying capital expenditure;
- (m) know the treatment of Production allowance, cost price ratio and balancing charge;
- (n) compute hydrocarbon tax and tertiary education tax of an oil and gas company;
- (o) understand the operations of Oil and Gas Companies (Tax Incentives, Exemptions, Remissions); tax credits for non-associated gas; incentives to deep water oil and gas projects; and Gas utilisation investment allowance;
- (p) understand the frontier exploration fund; drilling of prospects or leads by NNPC Limited; and frontier basin exploration and development plan committee;
- (q) describe the decommissioning and abandonment fund;
- (r) understand the establishment, funding, and utilisation of the host community fund;
- (s) know the offences and penalties applicable to petroleum companies;
- (t) know the registration and filing of returns for petroleum companies; and
- (u) understand the dispute resolution mechanisms provided in the PIA 2021.

28.2 Governance and regulatory institutions

The property and ownership of petroleum within Nigeria and its vesting of territorial waters, continental shelf and exclusive economic zone is vested in the Government of the Federation of Nigeria.

The objectives of governance and institutions are to:

- a) create efficient and effective governing institutions, with clear and separate roles for the petroleum industry;
- b) establish a framework for the creation of a commercially oriented and profit-driven national petroleum company;
- c) promote transparency, good governance and accountability in the administration of the petroleum resources of Nigeria;
- d) foster a business environment conducive for petroleum operations; and
- e) deepen local content practice in Nigeria oil and gas industry.

28.2.1 Powers of the Minister of petroleum resources

Section 3(1) of PIA 2021 provides that the Minister shall:

- (a) formulate, monitor and administer government policy in the petroleum industry;
- (b) exercise general supervision over the affairs and operations of the petroleum industry in accordance with the provisions of this Act;
- (c) report developments in the petroleum industry to the government;
- (d) represent Nigeria at international organisations on petroleum matters;
- (e) promote an enabling environment for investment in the Nigerian petroleum industry;
- (f) negotiate treaties or other international agreements on matters pertaining to petroleum on behalf of the government;
- (f) upon the recommendation of the Commission, grant petroleum prospecting licences and petroleum mining leases through the processes established in this Act;
- (g) upon the recommendation of the Commission and pursuant to the provisions of this Act and the regulations, revoke and assign interests in petroleum prospecting licences and petroleum mining leases;
- (h) delegate in writing to the Chief Executive of the Commission or Authority any power conferred on the Minister by or under this Act;
- (i) upon the recommendation of the Commission or Authority approve the fees for services rendered by the Commission or Authority in regulations;
- (j) upon the recommendation of the Commission or the Authority, direct in writing the suspension of petroleum operations in any area;
- (i) until arrangements to prevent danger to life or property have been made to his satisfaction, or
- (ii) where in his opinion, a contravention of this Act or any regulation made under this Act has occurred or is likely to occur.

Section 3(2-5) also provides that:

- a) the Minister may order a cutback of the levels of crude oil or condensate production in the context of international oil pricing agreements supported by Nigeria;
- b) the Minister shall have rights of pre-emption of petroleum and petroleum products marketed under any license or lease in the event of a national emergency under

- the First Schedule to this Act;
- c) the Minister shall give general policy directives to the Commission on matters concerning upstream petroleum operations and on matters relating to midstream and downstream petroleum operations as well as matters related to co-operation among the two entities as provided and the Commission shall comply with such directives; and
 - d) the Minister shall cause the general policy directives to be published in the Federal Government Gazette.

28.2.2 The Nigerian Upstream Petroleum Regulatory Commission

(a) Introduction

The Nigerian Upstream Petroleum Regulatory Commission (NUPRC) has the understated attributes:

- (i) the Commission is a body corporate with perpetual succession and common seal;
- (ii) the Commission has the power to acquire, hold and dispose of property;
- (iii) the Commission can sue and be sued in its own name; and
- (iv) the commission shall be responsible for the technical and commercial regulation of upstream petroleum operations

(b) Objectives of the Commission

The objects and functions of the Commission are limited to upstream petroleum operations. The objectives of the Commission as provided for in section 6 of PIA 2021, are to:

- (i) regulate upstream petroleum operations including technical, operational and commercial activities;
- (ii) ensure compliance with all applicable laws and regulations governing upstream petroleum operations;
- (iii) ensure that upstream petroleum operations are carried out in a manner to minimise waste and achieve optimal government revenues;
- (iv) promote healthy, safe, efficient and effective conduct of upstream petroleum operations in an environmentally acceptable and sustainable manner;
- (v) ensure efficient, safe, effective and sustainable infrastructural development of upstream petroleum operations;
- (vi) determine, administer and ensure the implementation and maintenance of technical standards, codes, practices and specifications applicable to upstream petroleum operations pursuant to good international petroleum industry practices;
- (vii) implement government policies for upstream petroleum operations as directed by the Minister of Petroleum in accordance with the provisions of the PIA;
- (viii) promote an enabling environment for investment in upstream operations;

- (ix) ensure strict implementation of environmental policies, laws and regulations for upstream petroleum operations;
- (x) ensure the implementation of national policies for upstream petroleum operations; and
- (xi) implement such other policies and objectives as are consistent with the provisions of the PIA

(c) The technical regulatory functions of the Commission

These include:

- (i) enforce, administer and implement laws, regulations and policies relating to upstream petroleum operations;
- (ii) ensure compliance with applicable national and international petroleum industry policies, standards and practices for upstream petroleum operations;
- (iii) establish, monitor, regulate and enforce health, safety and environmental measures and standards relating to upstream petroleum operations including;
 - management of petroleum reserves and installations, and
 - exploration, development and production activities onshore, frontier, shallow water and deep offshore acreages of Nigeria;
- (iv) administer, monitor and enforce compliance with the terms and conditions of leases and licenses and permits and authorisation issued to a company in respect of upstream petroleum operations;
- (v) set, define and enforce approved standards and regulations for design, construction, fabrication, operation and maintenance of plants, installations and facilities used or to be used in upstream petroleum operations including:
 - crude oil and natural gas evaluation and management,
 - upstream natural gas gathering,
 - natural gas treatment, and
 - the elimination of natural gas flaring and venting;
- (vi) keep public registers of:
 - licenses and leases granted by the minister and permits and other authorisation issued by the commission;
 - beneficial ownership, and
 - award, renewal, assignment, amendment, suspension and revocation;
- (vii) carry out enquiries, tests, audits or investigations and take other steps to monitor the activities of licensees, lessees or permit holders;
- (viii) establish and enforce standards relating to upstream petroleum operations;
- (ix) undertake evaluation of national reserves and develop policies for prudent

reservoir management practices;

- (x) maintain a Nigerian petroleum industry data bank comprising of materials, information and data acquired by, or submitted to, the Commission in the exercise of its statutory and regulatory functions;
- (xi) require lessees, licensees and permit holders to furnish and publish specified information relating to upstream petroleum operations in this Act and the National Data Repository Regulation, 2020;
- (xii) supervise and ensure accurate calibration and certification of equipment used for metering upstream petroleum operations, pursuant to applicable laws, and issue certificates of quality and quantity for petroleum produced;
- (xiii) publish reports and statistics on upstream petroleum operations to promote the growth of the petroleum industry;
- (xiv) advise the Minister on fiscal, operational, technical and other matters to enhance the upstream petroleum operations;
- (xv) issue permits and other authorisation as may be necessary under an upstream licence or lease, including:
 - drilling operations, and
 - design, construction and operation of facilities for upstream petroleum operations;
- (xvi) establish special laboratories to provide data storage and testing, quality assurance and certification for upstream petroleum operations;
- (xvii) perform technical evaluation and assessments regarding submissions made to the Commission by licensees, lessees or permit holders involved in upstream petroleum operations;
- (xviii) keep records, data and reports obtained from upstream petroleum operations, as may be required under any Act or regulation and give directive to any person, company or entity in that regard;
- (xix) manage and administer data regarding unallocated acreage;
- (xx) conduct bidding rounds for the award of petroleum prospecting licences and petroleum mining leases pursuant to this act and applicable regulations;
- (xxi) when requested, provide assistance to parties conducting upstream petroleum operation, where in the sole opinion of the Commission such assistance is merited;
- (xxii) approve field development plans for upstream petroleum operations as well as monitor its execution;
- (xxiii) compute, determine, assess and ensure payment of royalties, rents, fees, and other charges for upstream petroleum;
- (xxiv) operations as stipulated under this Act and any regulation;
- (xxv) establish parameters and codes of conduct for licensees, lessees or permit holders in the upstream petroleum operations;
- (xxvi) monitor the financial viability of licensees, lessees or permit holders with

respect to upstream petroleum operations;

- (xxvii) develop, maintain and publish a database of upstream petroleum operations;
- (xxviii) subject to the confidentiality provisions of section 83 (7) of the PIA, share information and data on the upstream petroleum operations with other government entities which have functions \with respect to the petroleum sector;
- (xxix) perform such other function as may be necessary to give effect to the provisions of this Act;
- (xxx) ensure and monitor performance of industry players and quality of the provision of services of servicing companies in the upstream petroleum industry;
- (xxxi) conduct studies relating to the economy, efficiency and effectiveness of the upstream petroleum industry; and
- (xxxii) issue certificates of quality and quantity to exporters of crude oil, natural gas and petroleum products from integrated operations and crude oil export terminals established prior to the effective date and the Commission shall have the power to monitor and regulate the operations of crude oil export terminals and the responsibility of weights and measures at the crude oil export terminals shall cease to exist from the effective date.

(d) Commercial regulatory functions of the Commission

The commercial regulatory functions of the Commission shall be to:

- i. review and approve the commercial aspects of field development plans in the upstream petroleum operations;
- ii. develop cost studies and benchmarks for the evaluation of upstream petroleum operations taking into account petroleum industry specific issues, including field size, reservoir depth, location of operations, technology applied, production methods and petroleum quality;
- iii. allocate petroleum production quotas for the purpose of curtailing export of petroleum in conjunction with NNPC Limited pursuant to regulations; and
- iv. where in situ facilities or fixed or floating platforms or vessels provide for fully integrated upstream and midstream petroleum operations, the Commission shall consider and the Commission shall be in charge of such integrated operations and petroleum operations may be considered integrated where there is a joint use of utilities used exclusively for the upstream and midstream operations.

(e) The functions of the Commission with respect to frontier basins

These are to:

- i. promote the exploration of the frontier basins of Nigeria;

- ii. develop exploration strategies and portfolio management for the exploration of unassigned frontier acreages in Nigeria;
- iii. identify opportunities and increase information about the petroleum resources base within frontier basins in Nigeria;
- iv. undertake studies, analyse and evaluate unassigned frontier basins in Nigeria;
- v. where data acquired and interpreted under a petroleum exploration licence, in the judgment of the Commission, require testing and drilling of identifiable prospects and leads, and no commercial entity has publicly expressed an intention of testing or drilling such prospects, the Commission shall, in line with section 64 (k) of this Act, request the services of NNPC Limited to drill or test such prospect and leads on a service fee basis to be charged to the Frontier Exploration Fund under the PIA;
- vi. where commercial discovery is made under subsection (2), NNPC limited shall have the first right of refusal in the award of the acreage for subsequent development and other petroleum operations in such frontier acreages under the PIA;
- vii. There shall be maintained, for the purpose of this section, a Frontier Exploration Fund which shall be 30% of NNPC Limited s profit oil and profit gas as in the production sharing, profit sharing and risk service contracts; and
- viii. NNPC Limited shall transfer the 30% of profit oil and profit gas under subsection (4) to the Frontier Exploration Fund escrow account dedicated for the development of frontier acreages and utilise the funds to carry out exploration and development activities in the frontier acreages subject to appropriation by the National Assembly.

(f) Power of the Commission

- (i) Enforce the provisions of any:
 - regulation made with respect to upstream petroleum operations;
 - regulations, policies or guidelines formerly administered by the Department of Petroleum Resources or the Petroleum Inspectorate, with respect to upstream petroleum operations, and
 - enactments with respect to the upstream petroleum industry made prior to the coming into force of this Act and any regulations made pursuant to powers given under them.
- (ii) Seal up any premises, under section 217 of this Act, including any facility or plant engaged in upstream petroleum operations, where there has been a contravention of this Act or any regulations made under this Act.

- (iii) Ensure compliance with the Nuclear Safety and Radiation Protection Act and such other legislative provisions as may be applicable in upstream petroleum operations.
- (iv) Set standards to promote the adoption of new technologies for upstream petroleum operations.
- (v) Require lessees, licensees and permit holders to publish specified and non proprietary information relating to upstream petroleum operations.
- (vi) Issue guidelines in accordance with the provisions of this Act or any regulation in respect of upstream petroleum operations.
- (vii) Recommend to the Minister the revocation or suspension of licences or leases in accordance with this Act and approve renewal of leases.
- (viii) Within the jurisdiction of the Commission, have access to:
 - areas or rights of way regarding licences, leases or any related offices or buildings where information or data are available for inspection under this Act; and
 - all installations to which this Act applies, including plants and stations of every description, for the purpose of inspecting the operations conducted therein after enforcing the provisions of this Act and any regulations made under it.
- (ix) Impose on a petroleum prospecting licence, petroleum exploration licence or any petroleum mining lease to which this Act applies, special terms and conditions consistent with this Act at the grant or renewal of the licence or lease.
- (x) Renew licenses and leases subject to the provisions of this Act.
- (xi) Do such other things as are necessary and expedient for the effective and discharge of any of its functions under this Act.

(g) Governing Board of the Commission

The Governing Board shall be responsible for the policy and general administration of the Commission and shall consist of:

- (i) one non-executive Chairman;
- (ii) two non-executive Commissioners;
- (iii) the Chief Executive of the Commission (in this Act referred to as the Commission Chief Executive;
- (iv) two other executive Commissioners who are responsible for finance and accounts and exploration and acreage management;
- (v) one representative of the Authority not below the rank of Director;
- (vi) one representative of the Ministry not below the rank of Director;

and

- (vii) one representative of the Ministry of Finance not below the rank of Director.

Appointments to the Board of the Commission shall be made by the President subject to confirmation by the Senate except for the appointments of ex-officio members in (v), (vi) and (vii) above.

A person appointed under (i) and (ii) *above* shall have at least 15 years post-qualification cognate experience in petroleum or other relevant sector of the economy and shall hold office for a period of five years and may be re-appointed for a further term of five years, u11 such terms and conditions as may be specified in the letter of appointment.

A Commissioner shall hold office for five years and may be re- appointed for a fm1her term of five years.

A non-executive Commissioner shall hold office on part- time basis.

The Board of the Commission may authorise in writing any Commissioner, committee of the Board of the Commission, the Commission Chief Executive or any other officer or employee of the Commission, to exercise any power or carry out any duty or function of the Commission under the PIA or regulation made under the PIA.

The proceedings of the Board of the Commission and other ancillary matters shall be as prescribed by regulation made under this Act.

(h) Functions of the Board of the Commission

The Board of the Commission shall:

- i. be responsible for the formulation of policy. supervision and giving strategic direction to the Commission;
- ii. provide general guidance for the carrying out of the functions of the Commission;
- iii. review and approve the business, strategic and operating plans of the Commission;
- iv. consider and approve the annual budget of the Commission before submission to the National Assembly for appropriation;
- v. approve the management accounts and audited accounts of the Commission and consider the management letter from the external auditors;
- vi. determine the terms and conditions of service of employees of the

Commission;

- vii. recommend remuneration, allowances, benefits and pensions or employees of the Commission in consultation with the National Salaries, Incomes and Wages Commission, having regard to the:
 - specialised nature of work to be performed by the Commission,
 - need to ensure the financial self-sufficiency of the Commission, and
 - remuneration and allowances paid in the private sector in upstream petroleum operations to individuals with equivalent responsibilities, expertise and skills;
- viii. structure the Commission into such number of departments as it deems fit for the effective performance of the functions of the Commission; and
- ix. perform such other functions as may be necessary for the efficient and effective administration of the Commission under the PIA.

(i) Remuneration and allowances of the Board of the Commission

- i. Commissioners shall be paid from the funds of the Commission such remuneration and allowances as applicable.
- ii. The Commission shall comply with the policy and guidelines of the National Salaries, Incomes and Wages Commission regarding remunerations.

(j) Suspension or removal of members of the Board of the Commission

A member of the Board of the Commission may be suspended or removed from office by the President, where the member:

- (i) is found to be:
 - unqualified for appointment under section 11 of this Act;
 - unqualified subsequent to his appointment, or
 - in breach of conflict of interest provisions in the Companies and Allied Matters Act or any regulation regarding conflicts of interest passed under this Act;
- (ii) ceases to be an employee of the ministry or agency he represents on the Board of the Commission;
- (iii) has demonstrated an inability to effectively discharge the duties of his office;
- (iv) has been absent from the meeting of the Board of the Commission for three consecutive times without the consent of the Chairman or in the case of the Chairman, without the consent of the President, except where good reason is shown for the absence;

- (v) is found guilty of serious misconduct by a court or tribunal of competent jurisdiction; or has, under the law in force in any country:
- been adjudged or declared bankrupt or insolvent and has not been discharged;
 - made an assignment to or arrangement or composition with his creditors which has not been rescinded or set aside, or
 - been declared to be of unsound mind.

28.2.3 Nigerian Midstream and Downstream Petroleum Regulatory Authority

Section 29 of PIA provides for the establishment of the Nigerian Midstream and Downstream Petroleum Regulatory Authority. It is a body corporate with perpetual succession and a common seal.

- a. The Authority shall have the power to acquire, hold and dispose of property, sue and be sued in its own name.
- b. The Authority shall be responsible for the technical and commercial regulation of midstream and downstream petroleum operations in the petroleum industry.
- c. The objects and functions of the Authority in this Part are limited to midstream and downstream petroleum operations in the petroleum industry.
- d. The objectives of the Authority shall be to:
 - i. regulate midstream and downstream petroleum operations, including technical, operational, and commercial activities;
 - ii. ensure efficient, safe, effective and sustainable infrastructural development of midstream and downstream petroleum operations;
 - iii. promote healthy, safe, efficient and effective conduct of midstream and downstream petroleum operations in an environmentally acceptable and sustainable manner;
 - iv. promote a competitive market for midstream and downstream petroleum operations;
 - v. promote the supply and distribution of natural gas and petroleum products in midstream and downstream petroleum operations and the security of natural gas supply for the domestic gas market;
 - vi. ensure compliance with applicable laws and regulations governing midstream and downstream petroleum operations;
 - vii. ensure crude oil supply for domestic refineries;

- viii. determine, administer and ensure the implementation and maintenance of technical standards, codes, practices and specifications applicable to upstream and downstream petroleum operations pursuant to good international petroleum industry practices;
- ix. implement Government policies for midstream and downstream petroleum operations as directed by the Minister and in accordance with the PIA;
- x. promote, establish and develop a positive environment for international and domestic investment in midstream and downstream petroleum operations;
- xi. ensure strict implementation of environmental policies, laws and regulations for midstream and downstream petroleum operations;
- xii. develop and enforce a framework on tariff and pricing for natural gas and petroleum products; and
- xiii. implement such other policies and objectives as are consistent with the provisions of the PIA.

Functions of the Authority

The functions of the Authority according to section 32 of the PIA are to:

- i. regulate and monitor technical and commercial midstream and downstream petroleum operations in Nigeria;
- ii. regulate commercial midstream and downstream petroleum operations, including:
 - petroleum liquids operations.,
 - domestic natural gas operations
 - export natural gas operations;
- iii. determine appropriate tariff methodology. Including for:
 - processing of natural gas;
 - transportation and transmission of natural gas; and
 - transportation of crude oil, and bulk storage of crude oil and natural gas;
- iii. setting cost benchmarks for midstream and downstream petroleum operations;
- iv. provide pricing and tariff frameworks for natural gas in midstream and downstream gas operations and petroleum products based on the fair market value of the applicable petroleum products;
- v. advise the government, government agencies and other stakeholders on commercial matters relating to tariff and pricing frameworks;
- vi. develop open rules applicable to petroleum liquids and natural gas transportation pipelines, terminal facilities and bulk storage facilities;
- vii. regulate the bulk storage, distribution, marketing and transportation pipelines of

- petroleum products;
- viii. grant, issue, modify, extend, renew, review, suspend, cancel, reissue or terminate licences, permits and authorisations for midstream and downstream petroleum operations;
 - ix. monitor and enforce compliance with the terms and conditions of licences, permits and authorisations issued by the Authority;
 - x. keep public registers of:
 - licences, permits and other authorisations issued by the Authority; and
 - renewals, assignments, amendments, suspensions or revocations;
 - xi. set, define and enforce approved standards and regulations for design, construction, fabrication, operation and maintenance of plants, installations and facilities used or to be used in midstream and downstream petroleum operations;
 - xii. carry out enquiries, tests, audits or investigations and take other steps to monitor the midstream and downstream petroleum operations;
 - xiii. ensure security of supply, development of the markets and competitions in the markets for natural gas and petroleum products;
 - xiv. ensure third party access to facilities under gas processing licences, transportation pipelines and transportation networks and midstream bulk storage facilities, where such facilities are operated for the account or the owner;
 - xv. develop rules for trading in wholesale gas supplies to gas distributors;
 - xvi. establish customer protection measures in accordance with the provisions of the PIA;
 - xvii. publish decisions, directions or determinations of the Authority that have implications for customers: and industry participants, together with the reasons for such decisions, directions or determinations which, in the opinion of the Authority, shall be published to promote the interests of customers with regard to midstream and downstream petroleum operation;
 - xviii. promote the principles of economic development of infrastructure with regards to midstream and downstream petroleum enquiries;
 - xix. promote competition and private sector participation in midstream and downstream petroleum operations;
 - xx. determine the domestic gas demand requirement and the crude oil required for the domestic crude oil supply obligation and ensure that economic and strategic domestic demands are met;
 - xxi. regulate the supply, distribution, marketing and retail of petroleum products;
 - xxii. administer and monitor strategic stocks of petroleum products;
 - xxiii. monitor the application of petroleum product prices, pricing formulae and frameworks;
 - xxiv. monitor market behaviour with respect to midstream and downstream petroleum operations;

- xxv. identify, investigate and prevent abuse of dominant positions and restrictive business practice with regard to midstream and downstream petroleum operations;
- xxvi. establish, monitor, regulate and enforce technical, health, environmental and safety measures relating to midstream and downstream petroleum operations;
- xxvii. develop, specify and monitor technical and safety standards for wholesale marketing, processing plant, retail marketing and bunkering of petroleum products;
- xxviii. ensure the accuracy of metering pumps and related measurement facilities in midstream and downstream petroleum operations;
- xxix. define and enforce approved standards and guidelines for the design, procurement, construction, operation and maintenance of plants, installations and facilities in the midstream and downstream petroleum operations;
- xxx. establish laboratories to provide data storage and testing, quality assurance and certification of crude oil, natural gas and petroleum products and regulate the activities of third-party laboratories used in midstream and downstream petroleum operations;
- xxxi. keep and classify records, data and reports as may be prescribed in regulations or guidelines;
- xxxii. ensure the promotion of safety and development of midstream and downstream petroleum operations;
- xxxiii. issue certificates of quality and quantity to exporters of crude oil, LNG and petroleum products;
- xxxiv. implement and enforce compliance with IAS, regulations and policies relating to midstream and downstream petroleum operations;
- xxxv. establish parameters and codes of conduct for operators in the midstream and downstream petroleum operations;
- xxxvi. monitor the financial viability of operators with respect to midstream and downstream petroleum operations;
- xxxvii. develop, maintain and publish a database of midstream and downstream petroleum operations;
- xxxviii. monitor and ensure that the quality of petroleum products sold in Nigeria conform to defined specifications;
- xxxix. establish, monitor and ensure compliance with the standards for the processing of petroleum products in Nigeria;
- xl. request information and documents relating to licenced activities, including pricing information and macro-economic data from any licensee or permit holder in midstream and downstream petroleum operations;
- xli. publish or direct licensees, lessees and permit holders to publish, in the interest of the public, information relating to midstream and downstream petroleum operations in accordance with applicable law or regulation;

- xlii. regulate the domestic base price mid the prices applicable to wholesale customers of the strategic sectors and gas distributors;
- xliii. perform such other function as may be necessary to give effect of the provisions of this Act;
- xliv. ensure and monitor performance parameters of industry players and the quality of service provided by servicing companies in the midstream and downstream petroleum industry; and
- xliv. conduct studies relating to the economy and efficiency and effectiveness of the midstream and downstream petroleum industry.

Regulations by the Authority

The Authority, in line with the provisions of section 33 of PIA, may make regulations:

- i. concerning the processing, refining, transmission, distribution, supply, sale and storage of petroleum and petroleum products as well as other midstream and downstream petroleum operations;
- ii. establishing those midstream and downstream petroleum operations to be subject to a licence or permit from the Authority;
- iii. establishing the application criteria and procedure for licences and permits for midstream and downstream operations;
- iv. establishing the procedure for review and approval of licence and permit applications for midstream and downstream petroleum operations;
- v. establishing the duration and conditions of licences and permits for midstream and downstream petroleum operations;
- vi. concerning those licences and permits already in effect prior to the date of any regulations issued by the authority for midstream and petroleum operations;
- vii. establishing the conditions and procedures for the transfer, surrender, suspension or revocation of licences and permits for midstream and downstream petroleum operations;
- viii. establishing the procedure for the modification of licences and permits for midstream and downstream petroleum operations;
- ix. establishing the penalties and enforcement mechanisms in respect of breaches of the regulations issued by the Authority;
- x. monitoring processes for midstream and downstream petroleum operations;
- xi. concerning the construction and operation of. third party access to infrastructure for midstream and downstream petroleum operations;
- xii. concerning the production, transportation, and sale of petrochemicals and

- lubricants;
- xiii. concerning the national strategic stock;
 - xiv. establishing tariffs for midstream and downstream petroleum operations;
 - xv. concerning domestic natural gas supply and demand;
 - xvi. concerning natural gas trading and export;
 - xvii. ensuring the continuity and security of the supply of natural gas, crude oil, and petroleum products to customers;
 - xviii. concerning rights of way and pertaining to surface rights;
 - xix. relating to the retail sale and distribution of petroleum products;
 - xx. concerning dispute resolution and customer protection;
 - xxi. regulating pricing regimes for midstream and downstream petroleum operations;
 - xxii. establishing fees payable to the Authority;
 - xxiii. concerning competition and anti-competitive behaviour;
 - xxiv. establishing public and non-public registries in respect of licences, permits and authorisations issued by the Authority, to be maintained by the Authority; and
 - xxv. any other matters as may be determined by the Authority under this Act which includes imposition of gas flare penalty arising from midstream operations which shall be for the credit of the Midstream and Downstream Gas Infrastructure Fund, and shall be utilised for midstream and downstream gas infrastructure investment within the Host Community of a designated facility.

Governing Board of the Authority

There is established a Governing Board that shall be responsible: for the policy and general administration of the Authority.

(i) Membership of the Board

As provided for in section 34 (1) of PIA, the board consists of:

- one non-executive Chairman;
- two non-executive members;
- the Chief Executive of the Authority referred to as the Authority Chief Executive;
- two other executive Directors responsible for finance and accounts and distribution systems, storage and retailing infrastructure;
- one representative of the Commission not below the rank of the executive commissioner;
- one representative of the Ministry of Petroleum Resources not below

the rank of a Director; and

- One representative of the Ministry of Finance not below the rank or Director; and one representative of the Ministry of Finance not below the rank of Director.
- (ii) Appointments to the Board of the Authority under this section shall be made by the President and be subject to confirmation by the Senate. except for the appointments of ex officio members under subsection (2) (e), (f) and (g), that is, the last three bullet points above.
- (iii) A person appointed under subsection (2) (o) and (b) shall have at least 15 years post qualification experience in petroleum or other relevant sector of the economy and shall hold office for a period of five years and may be reappointed for term of five years, on such terms and conditions as may be specified in the letter of appointment.
- (iv) Subject to subsection (4) and section 41 (3) of the PIA. a member of the Board of the Authority shall hold office for five years and may be re- appointed for a further term of five years.
- (v) A non-executive Board member shall hold office on part time basis.
- (vi) The Board of the Authority may authorize in writing any executive director, committee of the Board of the Authority, the Authority Chief executive or any other officer or employee of the Authority. to exercise any power or carry out any duty or function of the Authority under the PIA or regulation made under the PIA.

28.2.4 The Nigerian National Petroleum Company (NNPC) Limited

Section 53 of PIA provides for the incorporation of NNPC Limited.

- a)** The Minister shall within six months from the commencement of the PIA, cause to be incorporated under the Companies and Allied Matters Act, a limited liability company, which shall be called Nigerian National Petroleum Company Limited (NNPC Limited).
- b)** The Minister shall at the incorporation of NNPC Limited, consult with the Minister of Finance to determine the number and nominal value of the shares to be allotted, which shall form the initial paid-up share capital of NNPC Limited and the Government shall subscribe and pay cash for the shares.
- c)** Ownership of all shares in NNPC Limited shall be vested in the Government at incorporation and held by the Ministry of Finance Incorporated and the Ministry of Petroleum Incorporated in equal portions on behalf of the Federation and the Ministry of Petroleum Incorporated is incorporated under the provisions of the Eighth Schedule to the PIA.

- d) The Ministry of Finance Incorporated and the Ministry of Petroleum Incorporated in consultation with the Government may increase the equity capital of NNPC Limited.
- e) Shares held by the Government in NNPC Limited are not transferable including by way of sale, assignment, mortgage, or pledge unless approved by the Government and endorsed by the National Economic Council on behalf of the Federation.
- f) Notwithstanding any provision to the contrary in the Companies and Allied Matters Act and except by way of security, any sale or transfer of shares of NNPC Limited shall be at a fair market value and subject to an open, transparent and competitive bidding process and the sale or transfer of the shares of NNPC Limited shall be on equal proportion basis of shares held by the Ministry of Finance Incorporated and the Ministry of Petroleum Incorporated.
- g) NNPC Limited and any of its subsidiaries shall conduct their affairs on a commercial basis in a profitable and efficient manner without recourse to government funds and their memorandum and article of association shall state these restrictions and NNPC Limited.
- h) Allied Matters Act entity, declare dividends to its shareholders and retain 20% of profits as retained earnings to grow its business.

NNPC Limited shall operate as a companies and where NNPC Limited has a participating interest or 100% interest in a lease or licence, NNPC Limited shall pay its share of all fees, rents, royalties, profit oil shares, taxes and other required payments to Government as any company in Nigeria.

Transfer of assets and liabilities

The processes involved in the transfer of assets and liabilities of NNPC to NNPC Limited are provided for in section 54 of PIA.

- (a) The Minister and the Minister of Finance shall within 18 months of the effective date determine the assets, interests and liabilities of NNPC to be transferred to NNPC Limited or its subsidiaries and upon the identification, the Minister shall cause such assets, interests and liabilities to be transferred to NNPC Limited.
- (b) Assets, interests and liabilities of NNPC not transferred to NNPC Limited or its subsidiary under subsection shall remain the assets, interests and liabilities of NNPC until they become extinguished or transferred to the Government and six months following the determination, the Minister, the Minister of Finance and the Attorney-General of the Federation shall develop a framework for the payment of the liabilities not transferred to NNPC Limited and if such determination of which assets, interests and liabilities to be transferred has not been concluded

within the stipulated period of 18 months, all the assets, interests, liabilities of NNPC is deemed to be transferred to NNPC Limited after 18 months from the effective date.

- (c) NNPC shall cease to exist after its remaining assets, interests and liabilities other than its assets, interests and liabilities transferred to NNPC Limited or its subsidiaries has been extinguished or transferred to the Government.
- (d) Bonds, hypothecations, securities, deeds, contracts, instruments, documents and working arrangements with regards to assets, interests or liabilities transferred to NNPC Limited or any of its subsidiary which remains subsisting before the date of transfer shall, beginning from the date of transfer, be effective and enforceable against or in favour of NNPC Limited.
- (e) Any pending action or proceeding brought by or against NNPC before the transfer date with regard to assets. Interests or liabilities transferred to NNPC Limited may be enforced or continued by or against NNPC Limited as the successor of NNPC.
- (f) Notwithstanding the provisions of (e) above:
 - i. an action or proceeding shall not be commenced against NNPC Limited, its subsidiary, director, officer, employee or agent with regard to asset, interest or liability of NNPC Limited, where the time for commencing the action or proceeding would have expired had such asset, interest or liability not been transferred to NNPC Limited or its subsidiaries; and
 - ii. the transfer of asset, interest and liability of NNPC to NNPC Limited under shall not create or be deemed to have created a new cause of action in favour of:
 - a creditor of NNPC, or
 - party to a contract, agreement or arrangement with NNPC that was entered into before the date of transfer.
- (g) For the purpose of this section and the Second Schedule to the PIA, assets, interests and liabilities" means tangible, intangible, real or personal property, rights and obligations, in each case of all types.
- (h) Subject to any arrangements that NNPC has entered into, any debt to NNPC related to outstanding cash calls under joint venture agreements shall become debt of:
 - i. NNPC Limited where the assets have been transferred to NNPC Limited; and
 - ii. Government where the assets have not been transferred.
- (i) The initial capitalisation of NNPC Limited shall not be less than its financial requirements to effectively discharge its commercial role and deal with its obligations and liabilities transferred to NNPC Limited.

Appointment of NNPC Limited as agent of NNPC

The Minister shall upon incorporation of NNPC Limited, consult with the Minister of Finance to appoint NNPC Limited as agent of NNPC for the purpose of managing the process of winding down the assets, interests and liabilities of NNPC.

Subject to this appointment, the NNPC Limited shall have the power to deal with the applicable assets, interests and liabilities of NNPC and may enter into contract with third parties on such assets, interests and liabilities.

Pursuant to this appointment, the NNPC shall:

- (a) not deal with the applicable assets, interests and liabilities;
- (b) at the request of NNPC Limited execute and deliver any document and do such other acts or things as may be required by NNPC Limited with regard to any asset, interest or liability referred to above; and
- (c) pay a nominal fee of US \$1 to NNPC Limited as administrative charges on the applicable assets, interests and liabilities to which NNPC Limited has been appointed.

The cost of winding down the assets, interests and liabilities of NNPC shall be borne by the Government.

A cause of action shall not arise in tort, contract or otherwise between NNPC and NNPC Limited in respect of the applicable assets, interests and liabilities to which NNPC Limited has been appointed as agent of NNPC.

Any guarantee granted or issued by the Government with regard to the transfer of liability of NNPC to NNPC Limited shall be enforceable against the Government as if such liability was a liability of NNPC, provided that such guarantee was effective prior to such transfer.

Upon incorporation of NNPC Limited employees of NNPC and its subsidiaries shall be deemed to be employees of NNPC Limited on terms and conditions not less favourable than that enjoyed prior to the transfer of service and shall be deemed to be service for employment related entitlements as specified under any applicable law.

NNPC Limited shall continue to fulfill the statutory obligations of NNPC in relation to the pension scheme of employees of NNPC and its subsidiaries prior to the date of incorporation of NNPC Limited.

The Board of NNPC Limited

There shall be a Board of the NNPC Limited which shall perform its duties in accordance with the, PIA, the Companies and Allied matters Act and the articles of association of NNPC Limited.

Except as set out in this section, the composition of the Board of the NNPC Limited shall be determined in accordance with the Companies and Allied Matters Act and its Articles of Association.

The Board of NNPC Limited shall be appointed by the President and composed of:

- a non-executive Chairman;
- the Chief Executive of NNPC Limited;
- the Chief Financial Officer of NNPC Limited;
- a representative of the Ministry of Petroleum, not below the rank of a director;
- a representative of the Ministry of finance, not below the rank of a director; and
- six non-executive members with at least 15 years post qualification cognate experience in petroleum or any other relevant sector of the economy one from each geo-political zone.

A person to be appointed as the Chief Executive of NNPC Limited shall have extensive managerial, technical and professional knowledge in the petroleum or other relevant industry with at least 15 years post-qualification experience.

In the absence of the Chairman, the members of the Board of NNPC Limited may appoint a non-executive member of the Board to act as alternate Chairman.

The provisions of this section shall apply where NNPC Limited remains wholly-owned by the Government and where NNPC Limited is not wholly owned by Government, the composition of the Board of NNPC Limited shall be determined by the shareholders of NNPC Limited in accordance with the provisions of the Companies and Allied Matters Act and the articles of association of NNPC Limited.

The Board of NNPC Limited shall, within three months of the incorporation of NNPC Limited, develop formal and transparent process for the creation of its committees and nomination of members of the Board or NNPC Limited to the committees.

The mandate, composition and procedures of each committee of the Board of NNPC Limited shall be comprehensive and open for inspection by the shareholders of NNPC Limited.

The Board of NNPC Limited shall nominate non-executive members of the Board capable of exercising independent judgment to its committees where there is likelihood of conflict of interest.

The Board of NNPC Limited shall have committees for:

- i. ensuring the integrity of financial and non-financial reporting;
- ii. the nomination of Board of NNPC Limited members and key executives;
- iii. remuneration of members of the Board of NNPC Limited; and
- iv. any other committee as the Board of NNPC Limited may consider appropriate.

Members of the Board of NNPC Limited shall discharge their responsibilities in accordance with the highest standards, practices and principles of corporate governance.

The Board of NNPC Limited shall, upon request by one or more of shareholders holding not less than 10% of the voting interests in NNPC Limited, provide a comprehensive written explanation of any motion or decision taken by the Board of NNPC Limited to its shareholders, provided that the Board of NNPC Limited may withhold the explanation if permitted under a duty of Confidentiality NNPC Limited owed to any third party.

The objectives of NNPC Limited

The objectives of NNPC Limited shall include to:

- (a) carry out petroleum operations on a commercial basis, comparable to private companies in Nigeria carrying out similar activities including exemption to Public Procurement Act, Fiscal Responsibility Act including Treasury Single Account;
- (b) NNPC Limited to be vested as the concessionaire of all Production Sharing Contracts (PSC), Profit Sharing and Risk Service Contracts as the National oil company on behalf of the Federation in line with its competencies;
- (c) lift and sell royalty oil and tax oil on behalf of the Commission and the Service respectively for an agreed commercial fee and in the case of profit oil and profit gas payable to the concessionaire, NNPC Limited shall promptly remit the proceeds of the sales of the profit oil and profit gas to the Federal to the federation less its 30% for management fee and frontier Exploration Fund as specified in section 9 (4) of the PIA;
- (d) carry out test marketing to ascertain the value of crude oil and report to the Commission;
- (e) be vested with the rights to natural gas under production sharing contracts entered into prior to and after the effective date of the PIA;
- (f) carry out the management of production sharing contracts for a fee, based on the profit oil share or profit gas share;
- (g) with respect to any joint operating agreement in which NNPC is a party on the effective date assume the working interest held by NNPC irrespective of whether such licence or lease is converted under the PIA;
- (h) engage in the business of renewables and other energy investments;
- (i) promote the domestic use of natural gas through development and operation of large-scale gas utilisation industries;
- (j) maintain the role of NNPC, under section 54 of the PIA;

- (k) carry out task requested by the Commission or Authority on a fee basis and generally engage in activities that ensure national energy security in an efficient manner, in the overall interest of the Federation;
- (l) carry out such other tasks as may be determined by the Board of NNPC Limited; and
- (m) make NNPC Limited supplier of last resort for security reasons and all associated costs shall be for the account of the Federation.

28.3 General administration

The objectives are to:

- a) promote the exploration and exploitation of petroleum resources in Nigeria for the benefit of the Nigerian people;
- b) promote the efficient, effective and sustainable development of the petroleum industry;
- c) promote the safe and efficient operation of the transportation and distribution infrastructure for the petroleum industry;
- d) provide the framework for developing third party access arrangements to petroleum infrastructure;
- e) encourage and facilitate both local and foreign investment in the petroleum industry;
- f) promote transparency and accountability in the administration of petroleum resources in Nigeria;
- g) develop, where appropriate, competitive markets for the sales and distribution of petroleum and petroleum products;
- h) promote safe and affordable access to petroleum and petroleum products in Nigeria;
- i) promote the processing of petroleum within Nigeria and the development of fuel and chemical industry and other related value-added products and activities;
- j) create a conducive business environment for operations in the petroleum industry;
- k) promote the liberalisation of the downstream petroleum industry;
- l) establish an orderly, fair and competitive commercial environment within the petroleum industry; and
- m) ensure that petroleum operations are conducted in a manner that protects the health and safety of persons, property and the environment.
- n) The above stated information shall apply to:

- (i) activities within or associated with petroleum operations and the petroleum industry; and
- (ii) persons conducting such activities.

28.4 Licences and leases

Section 70 of PIA provides for recognised licences and leases relating to upstream petroleum operations. There are three types of licences. These are:

- (a) Petroleum exploration licence (PEL);
- (b) Petroleum prospecting licence (PPL); and
- (c) Petroleum mining lease (PML).

These licences are discussed in turn.

(a) Petroleum exploration license (PEL)

This may be granted to qualified applicants to carry out petroleum exploration operations on a non-exclusive basis. The features, as provided for under section 71 of PIA, are as stated below:

- i. the Commission shall be responsible for granting of petroleum exploration licences;
- ii. the holder of a petroleum exploration licence shall have non-exclusive right to carry out petroleum exploration operations within the area provided for in the licence;
- iii. a petroleum exploration licence shall be for three years and may be renewable for additional period of three years subject to fulfilment of prescribed conditions, but shall not include any right to win, extract, work, store, carry away, transport, export or otherwise treat petroleum discovered in or under the licence area;
- iv. a petroleum exploration licence may cover an area that includes petroleum prospecting licences or petroleum mining leases, provided that the holders of such licences or leases, shall have no obligation to purchase the results of any survey conducted under the petroleum exploration licence;
- v. a petroleum exploration licence granted in respect of frontier acreages may include a provision permitting the licensee to select, based on the result of his exploration work and be granted one or more petroleum prospecting licences prior to the termination of the licence containing the fiscal provisions stipulated in the PIA;

- vi. the Commission shall have sole right and title over any acquired raw and interpreted data obtained by a licensee pursuant to a petroleum exploration licence, provided that the licensee shall be entitled to grant a data use licence to a third party subject to a written authorisation by the Commission, which shall not be unreasonably withheld;
- vii. a licensee is entitled to a fee from a third party for data use licence granted to under the PIA and shall remit to the Commission any agreed portion of the fee due to the Commission;
- viii. exploration activities conducted pursuant to a petroleum exploration licence shall be monitored and administered by the Commission in accordance with regulations made under the PIA;
- ix. the Commission shall have sole right and title over all acquired and interpreted data from existing speculative survey agreements entered into with the Department of Petroleum Resources on behalf of the Government prior to the effective date; and
- x. the carrying out of geological, geophysical or geochemical surveys for scientific or educational purposes in relation to petroleum do not require a petroleum exploration licence, where the results or such surveys are not for sale or commercial gain.

b) Petroleum prospecting licence (PPL)

Petroleum prospecting licence, as provided for under section 72 of PIA, may be granted to qualified applicants to drill exploration and appraisal wells and do corresponding test production on an exclusive basis and carry out petroleum exploration operation on a non-exclusive basis.

- i. The holder of a petroleum prospecting licence shall, subject to the fulfilment of obligations imposed by the PIA have:
 - exclusive right to drill exploration and appraisal wells and non-exclusive right to carry out petroleum exploration operations within the area provided for in the licence; and
 - right to carry away and dispose of crude oil or natural gas won or extracted during the drilling of exploration or appraisal wells as a result of production tests, subject to the fulfilment of obligations imposed by the PIA.
- ii. A holder of the petroleum prospecting licence shall not be granted an extension except as prescribed under sections 78 (4), (9) and 79 (6) of the PIA.
- iii. Where a holder of a petroleum prospecting licence fails to fulfil any term or condition of the licence, it shall not, except as provided in the licence, give

the Minister a right of claim against the licensee or be deemed a breach of the licence, if the failure arises from force majeure.

- iv Where there is any delay by a licensee in the fulfilment of any term or condition of a petroleum prospecting licence caused by force majeure, the period of such force majeure shall be added to the period fixed for the fulfilment of the applicable term or condition, provided that such period shall not exceed three years in total after which, the licence may be terminated by the Commission or the licensee.
- v The Minister may grant a petroleum prospecting licence to a qualified applicant recommended by the Commission and shall not grant such licence to any other person and where the Minister does not grant the licence, the Minister shall inform the Commission in writing for the rationale of the decision.

c) Petroleum mining lease (PML)

Petroleum mining lease may be granted to qualified applicants to:

- i. win, work, carry away and dispose of crude oil, condensates, and natural gas on an exclusive basis;
- ii. drill exploration and appraisal wells and carry out the related test production on an exclusive basis; and
- iii. carry out petroleum exploration operations on a non-exclusive basis.

A Petroleum mining lease (PML) has the following features:

- (i) Granting authority - The Minister of Petroleum grants PML based on the recommendation of the Nigerian Upstream Petroleum Regulatory Commission.
- (ii) Eligibility - A PML is granted to qualified applicants who have discovered oil or gas in commercial quantities, performed conditions imposed in the Petroleum Prospecting License (PPL), and received approval for their field development plan from NUPRC.
- (iii) Rights - The lease grants exclusive rights to: *Win and Dispose*: Win, work, carry away, and dispose of crude oil, condensates, and natural gas.
- (iv) Prospecting operations - Carry out prospecting operations within the lease area on a non-exclusive basis.
- (v) Term - The lease is granted for a maximum period of 20 years.
- (vi) Renewal - The NUPRC is responsible for renewing PMLs, which can be renewed for one or more successive terms not exceeding 20 years each, provided the lease area continues to produce in paying quantities and the lessee has satisfied all rents, royalties, and fiscal obligations.
- (vii) Relinquishment: After 10 years of grant, the lessee must relinquish:

- Non-producing areas: All parcels not within the boundaries of the producing field; and
- Deep rights: Any formation deeper than the deepest producing formation, which vests in the government.

(viii) Revocation: The Minister of Petroleum can revoke a PML if the lessee fails to remedy a default within a specified period (not less than 60 days) after receiving a notice of default.

28.5 Fiscal/operating arrangement/regimes in the upstream sector

The Petroleum Industry Act (PIA) 2021, introduces significant changes to the fiscal and operating arrangements in Nigeria's upstream sector. Here is an overview of the key arrangements:

a) Joint venture (JV)

A JV is a collaborative agreement between the Nigerian National Petroleum Company Limited (NNPC Limited) and an international oil company (IOC) to explore, develop, and produce petroleum resources.

- Fiscal Terms: The PIA introduces a new fiscal regime for JVs, which includes a Hydrocarbon Tax (HT) and Companies Income Tax (CIT).
- NNPC Limited's Interest: NNPC Limited's interest in JVs is expected to be managed by NNPC Limited, with the option to participate in JVs on commercial terms.

b) Incorporated joint venture company (IJVC)

- NNPC Limited and other parties to joint operating agreements in respect of upstream petroleum operations, may on a voluntary basis restructure their joint operating agreement as a joint venture carried out by way of a limited liability company, each referred to as an "incorporated joint venture company" (IJVC), based on the principles established in the Second Schedule to the PIA.
- The IJVC referred to in subsection (I)–shall not be subject to the provisions of the Fiscal Responsibility Act and the Public Procurement Act.
- The proposed IJVC structure shall be an independent entity, having a strong commercial orientation and transparent company operation for the IJVC shareholders, with clear rules for accountability.

c) Production sharing contract (PSC)

- A PSC is a contractual arrangement between the government (represented by NNPC Limited) and an IOC, where the IOC bears the exploration and production risks and costs in exchange for a share of the production.
- Fiscal terms: The PIA retains the PSC regime, with some modifications, including the introduction of a new royalty regime.

- iii) Cost recovery: The PSC allows the contractor to recover costs from a portion of the production, with the remainder split between the government and the contractor.

d) Risk service contract (RSC)

- i. An RSC is a contractual arrangement where a contractor provides services to develop and produce petroleum resources in exchange for a fee.
- ii. Fiscal Terms: The PIA introduces RSCs as a new contractual model, with the contractor bearing the risks and costs of exploration and production.
- iii. Payment: The contractor is paid a fee for their services, which may be tied to production levels or other performance metrics.

e) Oil and gas free trade zone

- i. Definition: An Oil and Gas Free Trade Zone is a designated area where oil and gas activities can be conducted with favorable regulatory and fiscal terms.
- ii. Benefits: The zone is expected to attract investment, promote economic growth, and increase efficiency in the oil and gas sector.
- iii. Regulations: The PIA provides for the establishment of Oil and Gas Free Trade Zones, with specific regulations and incentives to be determined by the relevant authorities.

28.6 Accounting period

In relation to a company engaged in upstream petroleum operations, accounting period means:

- a) a period of one year commencing on January 1 and ending on December 31, of the same year (for on-going business);
- b) any shorter period commencing on the day the company first makes a sale or bulk disposal of chargeable oil, domestic, export or both, and ending on December 31, of the same year; or
- c) any period of less than a year being a period commencing on January 1 of any year and ending on the date in the same year when the company ceases to be engaged in petroleum operations; and
- d) If there is any dispute with respect to the date of the first sale of chargeable oil above or with respect to the date on which the company ceases to be engaged in petroleum operations, the Commission shall determine the same and there shall be no appeal.

Note: Accounting date or financial year end means the date on which a company usually prepares its accounting statement. Under the PIA, the accounting date is December 31, of each year.

28.7 Conversion, transition, and compliance

28.7.1 Conversion and transition: The following features apply:

- a) Existing oil prospecting licenses (OPLs) and oil mining leases (OMLs) can be converted to petroleum prospecting licenses (PPLs) and petroleum mining licenses (PMLs), respectively under the PIA.
- b) Operators have an 18-month timeline for voluntary conversion to PIA fiscal terms; otherwise, they can wait until their existing lease expires.
- c) Upon conversion, the hydrocarbon tax (HCT) and companies income tax (CIT) will apply, replacing the petroleum profits tax (PPT).

28.7.2 Conversion provisions

- a) **Voluntary conversion:** Existing holders of oil prospecting licences (OPLs) and oil mining leases (OMLs) may voluntarily convert to the new regime petroleum prospecting licences (PPLs) and petroleum mining leases (PMLs).
- b) **Automatic conversion:** If a lease expires, conversion becomes mandatory under the PIA.
- c) **Conversion deadline:** Operators had an 18-month window from the effective date (August 16, 2021) to convert voluntarily.
- d) **Contract:** A formal agreement must be signed between the licensee and the regulator to finalise the conversion.

28.7.3 Transition provisions

- a) **Dual tax computation:** In the year of transition, companies compute taxes under both the old Petroleum Profits Tax Act (PPTA) and the new PIA rules:
 - i. From January 1 to conversion date → PPTA applies.
 - ii. From conversion date to December 31 → PIA rules apply.
- b) **Non-converted licences:** Companies that do not convert will continue under PPTA until their licences expire.
- c) **Mixed licence scenario:** Companies with both converted and non-converted assets must file separate tax computations for each.
- d) **Compliance requirements**
 - i. Separation of upstream, midstream, and downstream operations
 - ii. Incorporation of Host Community Development Trust
 - iii. Establishment of Decommissioning and Abandonment Plan
 - iv. Preparation and submission of Environmental Management Plan
 - v. Filing tax returns based on PPLs or PMLs, with HCT and CIT payments collected by the Federal Inland Revenue Service (FIRS).

e) Fiscal provisions

- i. Hydrocarbon tax (HCT): 30% for converted PMLs and 15% for PPLs, applicable to onshore and shallow water operations, as well as marginal fields.
 - ii. Companies Income Tax (CIT): Applies to all upstream petroleum operations, with a focus on "reasonability" in expense deductibility.
 - iii. Royalty rates: Varying rates apply based on the location and type of operation.
- f) **Compliance matters**
Exemptions from HCT: Deep offshore operations, associated and non-associated gas and certain condensates are exempt.
- g) **Self-assessment and filing:**
 - (i) Companies must file annual tax returns with self-assessment forms and evidence of payment off self-assessed tax.
 - (ii) Revised estimated returns are allowed based on updated production and pricing data.
- h) **Losses and capital allowances**
 - i. Unabsorbed losses under PPTA can be carried forward and deducted under HCT and CIT.
 - ii. Un-recouped capital allowances may also be relieved, except for investment tax credit which is no longer applicable.
- i) **Key implications**
Operators not converting to PMLs will continue under the PPTA regime until their licenses expire.

28.8 Tax implications of a company with converted and non-converted licenses/leases

Companies holding both converted and non-converted licenses and leases face a unique tax scenario that requires careful compliance and dual reporting as described below:

- a) Dual tax computation requirement
 - i. A company with mixed assets.
 - ii. Where a company with mixed assets converted some to the PIA regime and left others under the old Petroleum Profits tax Acts (PPTA), tax computations must be prepared for each category.
- b) Converted assets:
 - i. Subject to hydrocarbon tax (HCT) and companies income tax (CIT) under the PIA.
 - ii. HCT rate: 15% for PPLs, 30% for PMLs.
 - iii. CIT rate: 30% across all petroleum operations.
- c) Non-converted assets:
 - i. Continue under **PPTA** until lease expires.
 - ii. Taxed solely under **petroleum profits tax**, typically at 85% for upstream

operations.

d) Filing obligations

i) The company must file **one annual tax return**, but it must include the following three separate tax computations:

- PPTA-based computation for non-converted assets;
- HCT computation for converted assets; and
- CIT computation for converted assets.

ii) Self- assessment forms and evidence of payment must accompany the filings.

e) **Transition year treatment**

In the year of conversion:

- i. taxes are computed under **both regimes**;
- ii. from January 1 to conversion date - PPTA rules apply; and
- iii. from conversion date to December 31 - PIA rules apply.

This split-year approach ensures accurate tax liability under each framework.

f) **Losses and capital allowances**

- i. **Unabsorbed losses** under PPTA can be carried forward and deducted under HCT and CIT.
- ii. **Unrecouped capital allowances** may also be relieved under the new regime.
- iii. However, investment tax credit (ITC) from the old regime is not transferable.

g) **Compliance risks**

- i. Failure to segregate computations correctly may lead to penalties.
- ii. Companies must notify the Federal Inland Revenue Service (FIRS) upon conversion and submit relevant documentation.

28.9 Sources of income accruing to petroleum companies

Under the Petroleum Industry Act (PIA) 2021, the sources of income accruing to petroleum companies are derived from various activities across the upstream, midstream, and downstream sectors of the petroleum industry. These sources include:

a) **Upstream petroleum operations**

- i. **Crude oil sales:** Revenue from the sale of crude oil produced from petroleum mining leases or prospecting licenses.
- ii. **Natural gas sales:** Income from the sale of associated and non-associated natural gas, including marketable natural gas.

- iii. **Condensates and natural gas liquids (NGLs):** Revenue from the production and sale of condensates and NGLs derived from crude oil or natural gas.
 - iv. **Exploration and production activities:** Income from exploration, appraisal, and development of petroleum resources.
- b) **Midstream petroleum operations**
- i. **Gas processing:** Revenue from processing natural gas into marketable natural gas, liquefied natural gas (LNG), or other by-products such as ethane, propane, and butane.
 - ii. **Pipeline transportation:** Income from the transportation of crude oil, natural gas, or petroleum products through pipelines, including tariffs and fees for third-party access.
 - iii. **Storage services:** Revenue from the bulk storage of crude oil, natural gas, or petroleum products in storage facilities.
 - iv. **Liquefied natural gas (LNG) operations:** Income from the production, storage, and export of LNG.
- c) **Downstream petroleum operations**
- i. **Refining:** Revenue from refining crude oil into petroleum products, such as gasoline, diesel, jet fuel, and other derivatives.
 - ii. **Petrochemical production:** Income from the production and sale of petrochemicals, including fertilizers and other industrial products.
 - iii. **Retail and distribution:** Revenue from the sale of petroleum products to retail customers through filling stations or distribution networks.
 - iv. **Wholesale supply:** Income from the wholesale supply of petroleum products to bulk customers.
- d) **Other sources of income**
- i. **Royalties and profit oil:** For companies operating under production sharing contracts, income may include profit oil or gas after deducting royalties and cost recovery.
 - ii. **Service fees:** Revenue from providing technical or operational services to other companies in the petroleum industry.
 - iii. **Trading and marketing:** Income from the trading and marketing of crude oil, natural gas, and petroleum products in domestic and international markets.
 - iv. **Export sales:** Revenue from the export of crude oil, LNG, and other petroleum products to international markets.

- v. **Investment income:** Earnings from investments in midstream and downstream infrastructure, such as pipelines, refineries, and storage facilities.

e) Incentives and tax benefits

- i. **Tax deductions:** Companies may benefit from tax deductions for contributions to host community development trusts, environmental remediation funds, and decommissioning and abandonment funds.
- ii. **Gas utilisation incentives:** Income from gas-based industries such as gas-to-liquids (GTL) plants, LNG plants, and fertilizer production may benefit from incentives under the PIA.

f) Refined product sales

Refined petroleum products Companies with refinery licences earn income by refining crude and selling products (gasoline, diesel, kerosene, LPG) into the domestic and export markets.

g) Pipeline transportation and processing fees

- i. **Transportation tariffs** Licence-holders operating gas and oil trunk pipelines earn fees for volumetric throughput, based on regulated tariff schedules.
- ii. **Processing, storage and regasification fees** Midstream players generate revenue by processing gas, storing crude or regasifying LNG for delivery to Domestic Gas Aggregators or end-users.

h) Technical service contracts

Service-remuneration fees under technical service contracts (TSCs), companies providing drilling, engineering or project management services invoice daily rates and project milestones rather than direct production shares.

i) Joint venture dividends and equity returns

- i. **Joint venture dividends:** International oil companies (IOCs) and the Nigerian National Petroleum Company (NNPC Ltd) share dividends from profit distributions in Joint Venture (JV) arrangements.
- ii. **Equity lifts:** Companies holding equity stakes in licences may elect to “lift” crude or gas in kind, monetising their share through direct sale or swap arrangements.

28.10 Royalties based on production and price using applicable rates

The Petroleum Industry Act 2021 (PIA) introduces both production-based and price-based royalties for crude oil and condensates, as well as a distinct royalty regime for

natural gas. This assessment outlines the applicable rates and illustrates how royalties are calculated under various production and price scenarios.

a) Royalties based on production volumes (for crude oil and natural gas)

Location	Royalty rate
Onshore areas	15%
Shallow waters	12.5%
Deep offshore (greater than 200m water depth)	7.5%
Frontier basins	7.5%

b) Royalties based on price

Brent price per barrel	Royalty rate
Below \$50	0%
At \$100	5%
At \$150	10%

Between \$50 and \$100 per barrel or \$100 and \$150 per barrel, the royalty by price is to be determined based on linear interpolation.

28.11 Allowable deductions and deductions not allowed

a) Allowable deductions (Section 263 of PIA)

In computing the adjusted profit of a company in upstream petroleum operations related to crude oil for any accounting period, there shall be deducted expenses wholly, reasonably, exclusively and necessarily incurred during that period include the following:

- i. rents incurred by the company for the period pursuant to a petroleum mining lease or petroleum prospecting licence;
- ii. all royalties the liability for which was incurred and were paid by the company during that period in respect of crude oil and associated gas and where a petroleum mining lease includes payments to the Federation Account related to production sharing, profit sharing, risk service contracts or other contractual features under a model contract and the company has incurred liability for such payments in kind or in cash;

- iii. expenses directly incurred for repair of plant, machinery or fixtures employed for the purpose of carrying on production activities or for the renewal, repair or alteration of production implement, utensils or articles. so employed;
- iv. any expenditure, tangible or intangible directly incurred in connection with the drilling of the first exploration well and the first two appraisal wells in the same field, whether the wells are productive or not, provided that subsequent exploration wells, appraisal wells and other wells shall be treated as qualifying drilling expenditure under the Fifth Schedule to this Act and 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 the Fifth Schedule to this Act;
- v. any amount contributed to a fund, scheme or arrangement approved by the Commission for the purpose of decommissioning and abandonment, provided that the surplus or residue of the fund shall be subject to tax under this Act at the end of life of the field, where such surplus is returned to the lessee;
- vi. all sums the liability of which was incurred by the company to the Federal Government or any State or Local Government Council by way of levies, stamp duties and fees;
- vii. costs of gas reinjection wells, which are re-injecting natural gas that otherwise would be flared, subject to ratification by the Commission; and
- viii. any amount contributed to any fund, scheme or arrangement approved by the Commission pursuant to the establishment of host communities development trusts, Environmental Remediation Fund, Niger Delta Development Commission and other similar contributions.

Note: Where a deduction has been allowed to a company under this section in respect of a liability of the company and the liability or part of the liability is waived, released or recovered, the amount of the deduction corresponding to the liability or part thereof shall be treated as income of the company of its accounting period, in which such waiver or release was made or given.

b) Deductions not allowed (Section 264 of PIA)

Subject to this Act, for the purpose of ascertaining the adjusted profit of a company in the accounting period from its upstream petroleum operations applicable to crude oil, no deduction shall be allowed in respect of:

- i. disbursements or expenses not being money wholly, reasonably, exclusively and necessarily incurred for the purpose of those operations;
- ii. expenditure for the purchase of information relating to the existence and extent of petroleum deposits, other than for the acquisition of geophysical,

- geological and geo-chemical data and information;
- iii. expenditure incurred as a penalty, natural gas flare fees or imposition relating to natural gas flare;
 - iv. financial or bank charges, arbitration and litigation costs, bad debts and interest on borrowing;
 - v. head office or affiliate costs, shared costs, research and development costs or any other like shared indirect production costs;
 - vi. production bonuses, signature bonuses paid for the acquisition of, or of rights in or over, petroleum deposits, bonuses or fees paid for renewing petroleum mining lease or petroleum prospecting licence or marginal field or fees paid for assigning rights to another party;
 - vii. tax inputted into a contract or an agreement on a net tax basis and paid by a company on behalf of the vendor or contractor;
 - viii. capital withdrawn or sum employed or intended to be employed as capital;
 - ix. capital employed in improvements as distinct from repairs;
 - x. sum recoverable under an insurance or contract of indemnity, except an amount that is not recovered under the scheme;
 - xi. rent of or cost of repairs to any premises or part of premises not incurred for the purpose of those operations;
 - xii. amounts incurred in respect of tertiary education tax, companies income tax, any income tax, profits tax or other similar taxes, whether charged within Nigeria or elsewhere;
 - xiii. the depreciation of any premises, buildings, structures, works of a permanent nature, plant, machinery or fixtures;
 - xiv. payment to provident, savings, widows and orphans or other society, scheme or fund; and
 - xv. any contribution to a pension, provident or other society, scheme or fund for production staff which may be approved, with or without retrospective effect, by the National Pension Commission subject to such general conditions or particular conditions in the case of the society, scheme or fund as the Service may prescribe, provided that any sum received by or the value of any benefit obtained by the company, from any approved pension, provident or other society, scheme or fund, in the accounting period of that company shall, be treated as income of the company for that accounting period.

28.12 Adjusted profit

This is defined in section 262(3) of PIA 2021, the profits of that period after the deductions allowed. The deductions allowed are the expenses specifically stated in section 263. those expenses that are WREN for the purpose of the business.

28.13 Treatment of losses in computation of hydrocarbon tax and companies income tax

Under the Petroleum Industry Act (PIA) 2021, the treatment of losses in the computation of hydrocarbon tax (HT) and companies income tax (CIT) for petroleum operations is outlined below:

a) Deduction of losses

- i. Losses incurred in any accounting period can be carried forward and deducted from the adjusted profits of subsequent accounting periods.
- ii. Losses are deducted in the order in which they are incurred, starting with the earliest loss (first-in, first-out basis).

b) Limitations on loss deduction

- i) Losses can only be carried forward and deducted against profits from the same class of chargeable tax:
 - **Class A:** Profits from petroleum mining leases (PMLs) selected under Section 93(6)(b) and (7)(b) of the PIA for onshore and shallow water areas; and
 - **Class B:** Profits from petroleum prospecting licenses (PPLs) selected under Section 93(6)(a) and (7)(a) of the PIA for onshore and shallow water areas.
- ii) Losses from one class cannot be used to offset profits from another class.

c) Carry-forward period

Losses can be carried forward indefinitely until they are fully utilised, provided the company continues to engage in petroleum operations.

d) Restrictions on loss deduction

- i) Losses cannot be deducted if they arise from:
 - penalties, fines, or disallowed expenses; and
 - costs exceeding the cost price ratio (CPR) limit of 65% of gross revenues in any accounting period. Such excess costs are carried forward but remain subject to the CPR limit in subsequent periods.

e) Treatment of losses for companies income tax (CIT)

i) Deduction of losses

- Losses incurred in any accounting period can be carried forward and deducted from the **assessable profits** of subsequent accounting periods.
- Losses are deducted in the order in which they are incurred (first-in, first-out basis).

ii) Consolidation of losses

- Losses from upstream petroleum operations can be consolidated across terrains (onshore, shallow water, and deep offshore) for the purpose of CIT computation.
- Losses from midstream and downstream operations are treated separately and cannot be consolidated with upstream losses.

iii) Carry-forward period

Losses can be carried forward indefinitely for CIT purposes, provided the company continues to engage in petroleum operations.

iv) Restrictions on loss deduction

Losses cannot be deducted if they arise from:

- disallowed expenses, such as penalties, fines, or non-operational costs; and
- costs exceeding the CPR limit for hydrocarbon tax purposes.

f) Special provisions for losses

i) Losses on transfer of assets

If a company transfers its trade or business to another company, any unutilised losses cannot be transferred to the acquiring company unless both companies are part of a recognised group and meet the conditions specified in the PIA.

ii) Losses in production sharing contracts (PSCs)

- For companies operating under PSCs, losses are consolidated across petroleum prospecting licenses (PPLs) and petroleum mining leases (PMLs) granted after the commencement of the PIA.
- Losses are applied to the two classes of chargeable tax separately.

iii) Losses from terminated operations

If a company ceases petroleum operations, any unutilised losses cannot be carried forward or deducted.

28.14 Treatment of unabsorbed losses and unrecouped capital allowances in hydrocarbon tax computations of transited companies

a) Background: Transition from PPTA to PIA

Under Nigeria's Petroleum Industry Act (PIA), companies that were operating and taxed under the Petroleum Profits Tax Act (PPTA) immediately before the PIA's effective date are deemed **transited companies**. Transitional provisions preserve certain tax attributes specifically unabsorbed losses and unrecouped capital allowances-so they can be carried forward into both hydrocarbon tax and companies income tax (CIT) computations under the PIA framework.

b) Detailed treatment of unrecouped capital allowances

The PIA preserves capital allowances unutilised under the PPTA as follows:

i) All transited companies (excluding PSCs) to:

- carry forward all unrecouped capital allowances; and
- deduct in computing both Hydrocarbon Tax and CIT profits for upstream activities.

ii) Companies under production sharing contracts (PSCs) to:

- continue to claim capital allowances to reduce Hydrocarbon Tax and CIT profits; and
- ITCs, however, may not be carried forward to offset CIT after transition.

Allowance type	Hydrocarbon tax	CIT
Unrecouped writing-down allowances	Yes	Yes
Balancing allowances on disposals	Yes	Yes
Investment tax credits (PSCs only)	No	No (post-PIA)

28.15 Assessable profit/loss and chargeable profit

In line with the provisions of section 262(4) of PIA 2021, the assessable profit of an accounting period shall be the adjusted profit of that period after any deduction allowed by section 265 of this Act (amount of any loss incurred by that company during any previous accounting period).

However, if the deductions allowed exceed the adjusted profit (very unlikely), this will result in assessable loss.

In Section 262(5) of PIA 2021 a chargeable profit of an accounting period is defined as the assessable profits of that period after the deduction allowed by section 266 of this Act (that is, capital allowances and production allowance).

It is pertinent to note that in determining the chargeable profit, the total cost shall not exceed the cost-price ratio as provided for in the Sixth Schedule to the Act (PIA 2021).

28.16 Income chargeable to hydrocarbon tax under the PIA 2021

Under the Petroleum Industry Act 2021, hydrocarbon tax (HT) applies to profits arising from specific upstream petroleum products. Section 262 of the PIA explicitly lists what constitutes income chargeable for HT purposes.

a) Chargeable income

- i) Crude oil profits from the sale or disposal of crude oil produced in the field, valued at the first upstream measurement point.
- ii) Field condensates profits on condensate liquids recovered alongside crude oil, measured and valued at the field's designated measurement point.
- iii) Natural gas liquids (NGLs) from associated gas profits on propane, butane, pentane and other liquids extracted from associated gas, measured upstream of any gas-processing facility.
- iv) Balancing charges adjustments reflecting differences between estimated volumes or values previously reported and the actual volumes or values sold or disposed.

All four categories above are chargeable to hydrocarbon tax.

b) Exclusions

Hydrocarbon tax does **not** apply to:

- i) associated gas (gaseous hydrocarbons not processed for liquids);
- ii) non-associated gas and any NGLs derived therefrom, if measured at downstream facilities;
- iii) field condensates or NGLs produced downstream of measurement points;
- iv) frontier acreage (until reclassified by the Commission); and
- v) deep-offshore operations (HT is restricted to onshore and shallow water).

c) Measurement and valuation

The "value of chargeable oil" for HT is determined as:

- i. proceeds from sales of chargeable oil plus the imputed value of oil disposed during the period; and
- ii. valuations rely on the same royalty price that the Commission uses for crude oil fields.

This ensures consistency between royalty and HT bases and strips out extraction, transportation and storage costs from the revenue calculation.

Tax rates and chargeable persons

License type	Area	HT rate	CIT rate
Petroleum prospecting licence (PPL)	Onshore and shallow water	15%	30%
Petroleum mining lease (PML)	Onshore and shallow water	30%	30%

All companies engaged in upstream operations under a PPL or PML are chargeable to HT at the above rates, irrespective of corporate structure (joint venture, partnership or sole company).

28.17 Exemptions from hydrocarbon tax

The Petroleum Industry Act (PIA) 2021 revamps Nigeria's upstream fiscal regime and replaces petroleum profit tax with a dual-tax system - hydrocarbon tax (HT) and companies income tax (CIT). While HT applies to most onshore and shallow-water upstream operations, the Act carves out a number of clear exemptions.

a) Acreage and field-based exemptions

i) Frontier acreages

- All frontier acreage is **exempt** from HT until either
 - reclassified as onshore/shallow water upon a significant commercial discovery, **or**
 - converted into a petroleum prospecting licence (PPL) or petroleum mining lease (PML) under the PIA.

ii) Deep offshore acreages

- Petroleum operations in water depths beyond 200 metres carry **zero HT**. Deep offshore fields are exempt from HT entirely.

iii) Non-Commercial/Pre-Production Fields

- Any PPL that has yet to commence commercial production (for example, certain marginal fields pending development) is not chargeable to HT until production begins.

b) Product-based exemptions

- i) Associated gas not upstream of measurement point
 - Natural gas that is produced alongside oil but does not cross the designated upstream **measurement point** is exempt from HT. This ensures that gas used for reinjection, flare avoidance or local consumption before measurement attracts no HT.
- ii) Non-associated gas and derived liquids
 - Gas and gas liquids from non-associated gas fields (including condensates, natural gas liquids) remain outside HT's scope—even if later mixed with crude oil—provided they are measured at the downstream exit point of a gas processing plant.

c) Transaction-based exemptions

- i) Cumulative production allowance
 - A fixed per-barrel production allowance (different rates for existing vs. new leases) reduces the HT base. While not a strict “exemption,” this allowance effectively shields a volume of output from HT.
- ii) Frontier Exploration Fund (FEF) Carve-Outs
 - 30% of NNPC's profit oil/gas that flows into the Frontier Exploration Fund is exempt; this fund finances frontier basin exploration and is itself non-taxable.

d) Host community and decommissioning trust exemptions

- i) Host communities trust contributions
 - The mandatory 3% annual operating-expenditure contribution to a Host Community Development Trust is exempt from HT. It also reduces the HT-chargeable profit base (deductible).

e) Decommissioning and abandonment funds

- i) Contributions to escrowed abandonment funds, required before field retirement, are deductible for HT. While not a permanent exemption, pushing these costs into an escrow account before end-of-life ensures they do not inflate the HT base in that final year.

f) Timing and transitional exemptions

- i) Existing OPL/OML transitional period
 - Fields still under pre-PIA oil prospecting licences (OPLs) and oil mining leases (OMLs) remain under the old PPTA until they convert

to PPLs/PMLs. That PPT regime has its own carve-outs and does not expose them to HT until conversion.

ii) Cost-recovery timing

- Unclaimed capital expenditures may be notified to FIRS up to 5 months after year-end (or as extended), effectively exempting late costs from HT in Year 1 but allowing deduction in Year 2.

28.18 Treatment of qualifying capital expenditure

a) Qualifying capital expenditure

Under the Petroleum Industry Act (PIA) 2021, capital allowance is granted for qualifying capital expenditures (QCEs) incurred in the course of petroleum operations under a petroleum mining lease (PML) or a petroleum prospecting licence (PPL). Capital allowance remains a key deductible expense for petroleum upstream companies when calculating hydrocarbon tax (HT) and companies income tax (CIT). It is claimable on the following qualifying capital expenditure as follows:

- qualifying plant expenditure;
- qualifying pipeline expenditure.
- qualifying building expenditure; and
- qualifying drilling expenditure.

b) Rates of capital allowance

Capital allowance is claimed on qualifying capital expenditure on the straight lines basis at the rate of 20% per annum for the first four years and 19% in the fifth year. 1% is retained in the books in the fifth year until the asset is disposed of.

The petroleum investment allowance has been abolished under the PIA 2021. It is replaced by production allowance.

c) Treatment of capital allowance in tax computation

Hydrocarbon tax: Capital allowance is computed separately per field and it is deducted after adjusted profit is computed.

Companies income tax: Capital allowance is aggregated at the company level (not per field) and it is deducted after accounting profit and other allowable deductions.

Illustration 28.1

The accounts of Marian Oil Limited, a petroleum company for the year ended December 31, 2024 revealed the schedule of qualifying capital expenditure:

Type	Date of acquisition	Amount (N'000)
Plant and machinery	July 2023	4,500,000
Fixtures and fittings	July 2022	4,000,000
Pipeline	Feb. 2024	6,000,000
Building	Feb. 2021	5,500,000
Plant and machinery	July 2020	6,000,000

You are required to compute capital allowance for the relevant year of assessment

Solution to illustration 28.1

Marian Oil Limited

Computation of capital allowance for 2024 Tax Year

QCE	Date	Age	Amount N'000	Rate	Capital allowance N'000
Pipeline	2024	1	6,000,000	20%	1,200,000
Plant & Mach	2023	2	4,500,000	20%	900,000
Fixtures	2022	3	4,000,000	20%	800,000
Building	2021	4	5,500,000	20%	1,100,000
Plant & Mach	2020	5	6,000,000	19%	<u>1,140,000</u>
Total					<u>5,140,000</u>

28.19 Production allowance and its treatment

Production allowance was introduced as a replacement for Investment tax credit applicable in the repealed Petroleum Profit Tax Act. This is a very good attempt by the government in granting allowances which are directly linked to production as against capital investment as was in practice under the old law (Petroleum Profit Tax Act).

Production allowances for crude oil are also applicable to condensates and liquid natural gas liquids.

The Sixth schedule (first part) to the PIA 2021 provides the production allowances for each of the locations/ area of activities. This is as shown in the table below:

Production allowances schedule

S/N	Location	Production allowance
1	Crude oil production by leases which are converted oil mining leases based on a concession contract	The lower of US \$2.50 per barrel and 20% of the fiscal oil price
2	Leases granted after the commencement the Act:	
A	Onshore areas	The lower US \$8 per barrel and 20% of the fiscal oil price up to a cumulative maximum production of 50 million barrels from commencement of production and the lower of US \$4 per barrel and 20% of the fiscal oil thereafter
B	Shallow waters	The lower US \$8 per barrel and 20% of the fiscal oil price up to a cumulative maximum production of 100 million barrels from commencement of production and the lower of US \$4 per barrel and 20% of the fiscal oil thereafter
C	Deep onshore and frontier	The lower US \$8 per barrel and 20% of the fiscal oil price up to a cumulative maximum production of 500 million barrels from commencement of production and the lower of US \$4 per barrel and 20% of the fiscal oil thereafter

There is no chargeable tax rate for upstream petroleum operations in the deep offshore waters. The companies will however be subjected to Companies Income Tax Act.

28.20 Cost price ratio limit

Paragraph 2(1) of the Sixth Schedule to PIA 2021 provides that all costs prescribed under section 263 and under the Fifth Schedule to the Act, excluding those related to section 263(1)(a), (b) and (h), in an accounting period the sum of which is eligible for deduction under the hydrocarbon tax shall be subject to a cost price ratio limit of 65% of gross revenues determined at the measurement points.

The Sixth Schedule further stipulates that any excess costs not deductible in a particular year of assessment may be carried forward to subsequent years.

However, where any costs exceed the cost price ratio limit upon the termination of upstream petroleum operations related to crude oil, such costs shall not be deductible for purpose of calculation of the hydrocarbon tax.

The format for computation of cost price ratio limit in line with the circular issued by the Federal Inland Revenue Service is as shown below:

Cost price ratio (CPR) limit

S/N	Description	Sub-total US \$	Total US \$
A	Revenue		
	Fiscal value of crude oil sold	X	
	Value of condensate from associate gas sold	X	
	Value of natural gas liquid from associated gas sold	<u>X</u>	
	Total gross revenue		<u>XX</u>
	Minimum allowable costs @ 65% of sales value		<u>XX</u>
	Total costs incurred		
	Royalty incurred and paid	X	
	Other operating costs (section 263)	X	
	Environmental remediation fund	X	
	Excess costs brought forward (if any)	X	
	Unrecouped capital allowances brought forward	X	
	Total capital allowances for the year	<u>X</u>	
B	Total eligible costs	<u>XX</u>	

C Less: Exempted costs incurred pursuant to section 263(1)(a), (b), and (h)

Royalty incurred and paid X

NDDC charge X

Concession rentals X

Host community fund X

Environmental remediation fund X

C1 Total exempted costs XX

C2 **Net total costs to subject to CPR (B - C1)** **XX**

Maximum allowable costs:

The lower of:

Net total costs to be subject to CPR

and

CPR @ 65% of gross revenue

D Total allowable cost (in line with the practice of FIRS) = C1 + C2 (that is, Exempted cost + CPR restricted cost)

Excess total costs carried forward = total eligible costs (incurred by the company) - total allowable cost

28.21 Balancing charge

This occurs when the sales proceeds from disposal of a qualifying capital expenditure item is greater than the tax written down value of such QCE at the point of disposal. This creates a sort of gains to the company. Balancing charge will form part of the income to be charged to hydrocarbon tax but shall not be included as part of the gross revenue in the determination of CPR limit.

28.22 Hydrocarbon tax

In line with the provisions of section 260 of PIA, hydrocarbon tax is payable by companies engaged in upstream petroleum operations onshore and shallow water. Hydrocarbon tax does not apply to associated natural gas, including liquids produced in the fields and contained in the rich gas, and non-associated natural gas. The hydrocarbon tax is the fiscal regime which applies to upstream petroleum operations in relation to crude oil, field condensates and natural gas liquids derived from associated gas and is charged and assessed on the profits derived from such operations and payable within each accounting period. Hydrocarbon tax is assessed based on actual year basis.

The tax rates imposed under the hydrocarbon tax is determined by the license acquired by the company during that accounting period, that is, a PML or a PPL. Thus, according to S.267 of the Act, the chargeable tax for any accounting period of a company shall be a percentage of the chargeable profit for that period aggregated which shall be:

- i. 30% of the profit from crude oil for PMLs with respect to onshore and shallow waters; and
- ii. 15% of the profit from crude oil for onshore and shallow water and for PPLs and marginal fields.

Petroleum companies are required to pay estimated hydrocarbon tax due in 12 equal instalments, together with the final (13th month) instalment. The first instalment is due in the last day of the third month (March) of the financial year. The second instalment through the tenth, will be from April to December. Then, the 11th and 12th instalments will be paid in January and February of the following financial, by which time the actual hydrocarbon tax will be available. The difference between the actual hydrocarbon tax and the 12 advanced instalments paid so far is what is referred to as the 13th month instalment. This is expected to be paid within 21 days of receipt of the notice of assessment.

28.23 Companies income tax

Petroleum producing companies operating in the upstream sector are mandated to pay in an assessment year, companies income tax at the rate of 30%.

Companies income tax is assessed based on preceding year basis (PYB).

The format for the determination of companies income tax is as shown below:

Ajose Energies Limited
Computation of companies income tax
For the relevant assessment year

S/N	Description	Amount US \$	Total amount US \$
Income:			
	Fiscal value of crude oil sold or disposed	x	
	Value of condensate from associate gas sold	x	
	Value of natural gas liquid from associated gas sold	x	
	Fiscal value of associate natural gas sold, transferred or disposed	x	
	Fiscal value of non-associate natural gas sold, transferred or disposed	x	
	Value of condensates and natural gas liquids produced from non-associate gas field and sold or disposed	x	
	Value of condensates or natural gas liquids produced from gas processing plants sold or disposed	x	
	Value of condensate or natural gas liquid from associated gas downstream of measurement points and sold	x	
	Realised exchange gains/(loss)	x	
	Interest income	x	
	Other incidental income	<u>x</u>	
A	Gross total income		XX
Allowable deductions:			
	Royalty incurred and paid	x	

	Other operating costs under section 263	x	
	CITA allowable deductions	<u>x</u>	
B			<u>XX</u>
	Assessable profit (A - B)		XX
	Add balancing charge		x
	Less: Losses b/f		<u>(x)</u>
C			XX
	Less: Capital allowances		
	For the year	x	
	Unutilised brought forward	<u>x</u>	
D			<u>XX</u>
E	Total profit (C - D)		<u>XX</u>
F	Companies income tax @ 30% (30% of E)		<u>XX</u>

Note: Cost price ratio (CPR) limit does not apply in the determination of allowable expenses and companies income tax payable.

The table below shows how operating costs are computed in line with the provisions of PIA 2021 and Companies Income Tax Act, 2004 (as amended):

Statement of operating cost		
S/N	Account name	Amount
		US \$
1	Concession rentals	
2	Repairs of plant, machinery, and fixture	x
3	Repairs or alteration of production implement, utensils	x
4	Cost of gas reinjection wells	x
5	First exploration well costs	x

6	First two appraisal wells costs	x
7	NDDC charge	x
8	Environmental remediation fund contribution	x
9	Host community trust fund contribution	x
10	Stamp duty	x
11	decommissioning	<u>x</u>
A	Total allowable costs (section 263)	<u>XX</u>

Allowable expenses for CITA

1	Rent	x
2	Finance cost	x
3	Administrative expenses	x
4	All indirect costs expenses (including costs above fields)	x
5	etc	<u>x</u>
B	Total allowable costs (CITA)	<u>XX</u>

Note: Only part A above is allowed for hydrocarbon tax computation, while for companies income tax computations, A + B, is applicable.

28.24 Tertiary education tax

Every oil producing company is required to compute and pay tertiary education tax (TET) in each of its accounting periods. The tax is applicable on the assessable profits determined under the Companies Income Tax at the rate of 3%.

The TET is not an allowable deduction in the computation of either the companies income tax or hydrocarbon tax.

Illustration 28.3

ABC Ltd has an assessable profit of \$200,000,000 in its companies income tax computation for 2025 Year of assessment. What is its TET in that year?

Solution to illustration 28.3

ABC Ltd Computation of TET Liability TET Rate X Assessable Profit

$$3/100 \times 200,000,000 = \$6,000,000.$$

28.25 Oil and Gas Companies (Tax Incentives, Exemptions, Remissions, etc) Order, 2024

A significant development emerged in Nigeria's oil and gas sector on February 28, 2024, when President Bola Ahmed Tinubu signed the Oil and Gas Companies (Tax Incentives, Exemption, Remission, etc.) Order 2024. This Order, empowered by the Companies Income Tax Act (CITA), to provide tax incentive investment through tax breaks. Pursuant to the power granted by the order, the Minister of Finance ('MOF'), in collaboration with the Federal Inland Revenue Service ("FIRS"), Nigerian Upstream Petroleum Regulation Commission ("NUPRC") alongside other relevant stakeholders, subsequently issued implementation guidelines to clarify the application process and eligibility criteria.

This order and implementation guidelines apply to the following:

- a) Non-associated gas (NAG) greenfield developments in onshore and shallow water locations; and
- b) Midstream gas companies carrying out gas utilisation projects.

The Implementation guidelines are addressed in three subdivisions:

- a) The Federal Inland Revenue Service guideline on the applicability of tax credits and allowances for Non-Associated Gas Greenfield Development;
- b) The Federal Inland Revenue Service Guideline on the applicability of the midstream capital and gas utilisation allowance; and
- c) The Nigerian Upstream Petroleum Regulatory Commission guideline on hydrocarbon liquid content in a Non-Associated Gas Field.

28.26 Tax credits for non-associated gas

This is the first category of incentives under the Order. The guideline on the applicability of tax credits and allowance for Non-Associated Gas Greenfield Development aims to provide clarity on the fiscal incentives available for Non-Associated Gas (NAG) greenfield developments in Nigeria. It outlines the conditions under which companies are eligible for Gas Tax Credits (GTC) or Gas Tax Allowances (GTA) based on the volume and composition of hydrocarbon liquids (HCL) produced alongside natural gas.

a) Eligibility criteria for GTC

NAG greenfield developments in onshore and shallow water locations with a first commercial production date of January 1, 2029, or earlier, are eligible for a GTC equal to

- i. US\$1.00 per thousand cubic feet or 30% of the fiscal gas price, whichever is lower, provided;
- ii. the HCL content does not exceed 30 barrels per million standard cubic feet ("MMSCF"); and
- iii. the HCL is higher than 30 barrels per million standard cubic feet but less than 100 barrels per MMSCF, the tax credit is worth US\$0.50 per thousand cubic feet, or 30% of the fiscal gas price, whichever is less.

b) Eligibility criteria for GTA

Companies commencing gas production after January 1, 2029, are eligible for GTA at a rate of US\$0.50 per MCF or 30% of the fiscal gas price, whichever is lower, if the HCL content is not more than 100 barrels per MMSCF.

Nonetheless, if HCL exceeds 100 barrels per MMSCF, the company is required to revert to pre-existing legislations. The measurement of the HCL in all circumstances is to be determined by the NUPRC.

c) Carry-forward and expiry of GTC surplus

Companies that accumulate more GTC than needed to offset their tax liabilities can carry forward these excess credits for up to three years. However, if these excess credits are not utilised within this timeframe, they expire and can no longer be used to reduce taxes. Additionally, companies eligible for GTC for their greenfield gas projects are ineligible to receive any other incentives or benefits under the Associated Gas Framework Agreement for the same project. This measure aims to ensure fairness and prevent companies from receiving double benefits for the same project, thereby promoting a balanced fiscal regime within the Nigerian oil and gas industry.

d) Time limitation and claim conditions

A company is eligible to claim the GTC if its HCL content remains below 100 barrels MMSCF and it achieved first gas production on or before January 1, 2029. This claim can be made for a maximum of 10 years from the first gas production date. Conversely, the GTA can only be declared by a business that commenced producing commercial gas after January 1, 2029, as long as the HCL content in each MMSCF remains below 100 barrels. The Order stipulates that the gas tax credit any company is entitled to shall not exceed the income tax payable by the company for that year.

Transition from gas tax credit (GTC) to gas tax allowance (GTA)

Companies granted GTC in Greenfield development may be eligible to GTA after the expiration of 10 years in so far it achieved its first gas production on or before January 1, 2029.

28.27 Incentives to deep water oil and gas projects

This is the third category of incentives under the Order. The Order empowered the Minister for Finance to introduce incentives to ensure that investments for deep water oil and gas projects achieve a competitive internal rate of return (the “**Deep-Water Oil and Gas Incentives**”). It further mandates the Ministry of Finance Incorporated and the Ministry of Petroleum Incorporated to take steps to procure the Nigerian National Petroleum Company Limited to consider and recommend commercial enablers for new investments in the deep water pending the time the Deep-Water Oil and Gas Incentives are introduced. The Minister of Finance is empowered to issue implementation guidelines for the provisions of the Order in collaboration with the FIRS, NMDPRA, NUPRC, and other relevant stakeholders.

28.28 Gas utilisation investment allowance (GUIA)

This is the second category of incentives under the Order where the Federal Inland Revenue Service Guideline on the applicability of the midstream capital and gas utilisation allowance (GUIA) the gas utilisation investment allowance is granted on qualifying capital expenditure incurred on plant and equipment by midstream gas companies in respect of any new and ongoing project in the midstream oil and gas industry engaged in processing and transportation of natural gas as regulated by the Nigerian Midstream and Downstream Petroleum Regulatory Authority (NMDPRA). This allowance serves to reduce the company's taxable profits in the qualifying year. The gas utilisation investment allowance is set at 25% of the actual cost of the purchased plant and equipment.

a) Eligibility for GUIA

To qualify for the GUIA, a company must have incurred eligible capital expenditure on plants and equipment in one or more of the following midstream gas operations:

- i. transportation of natural gas to gas conditioning and processing plants.
- ii. transportation of natural gas from gas conditioning and processing plants to gas-based industries and other end-use customers, specifically not exceeding exit points connecting gas distribution pipelines and networks.
- iii. gas processing and conditioning plants.
- iv. gas bulk storage infrastructures installed which are not for sale, but holds stock of plant condensates, liquefied petroleum gas (LPG), or liquefied natural gas (LNG).
- v. companies engaged in these operations must possess the relevant licenses as issued by the NMDPRA. Furthermore, under Section 39 of CITA, a company will only be granted the gas utilisation investment allowance after the expiration of the tax-free period granted under section 39(1) of CITA. It's important to note that a company that has already enjoyed the 25% GUIA will not be entitled to any other investment allowance under Section 39 of CITA.

b) Qualifying plant and equipment for GUIA

Qualifying plant and equipment are tangible assets and other components comprising a plant or equipment used for gas processing and transportation in midstream gas operations, with a useful life exceeding one year.

To be eligible for GUIA, the following conditions must be met:

- i. the cost of the qualifying plant and equipment must have been incurred by the company;
- ii. the cost must have been incurred from the commencement date of this incentive order;
- iii. proof of ownership of qualifying plant and equipment must be provided; and
- iv. evidence of direct use of the plant and equipment for gas processing and transportation in midstream gas operations is required.

c) Exemptions

The gas utilisation investment allowance will not apply under certain circumstances if:

- i. the company sells or transfers the plant and equipment to another company not engaged in the same or related business within five years of incurring the expenditure;
- ii. there is an appropriation of the plant and equipment for purposes other than gas utilisation within five years of incurring the expenditure;
- iii. the cost incurred on the plant and equipment is not a bona fide business transaction or is an artificial or fictitious transaction; and
- iv. the company is an end-product user of gas as feedstock, energy source, and related purposes.

d) Non-interference with capital allowance

- i. The GUIA does not reduce the value of any asset on which capital allowance is claimable under the Companies Income Tax Act. If a company claims capital allowance for an asset, such as a piece of machinery or equipment, the value of that asset for capital allowance purposes remains the same even if the company also claims GUIA.
- ii. The capital allowance available under the CITA will continue to apply to eligible companies. This means that the company can still claim the regular capital allowance on its assets in addition to any GUIA claimed.
- iii. The company is also entitled to other deductions, allowances, and incentives available under the CITA and any other relevant legislation. This ensures that companies can benefit from both the regular tax incentives and the specific GUIA without any reduction in the value of their assets for capital allowance purposes.

e) Order implementation and sunset clause

Paragraph 5.0 of the Implementation Guidelines clarifies the Order's lifespan. The Order will no longer be in effect after the fiscal incentives it provides are included in official legislation. In a similar vein, if first gas production is not reached by January 1, 2029, the Gas Tax Credit provided by the Order will no longer be valid. In cases where an inevitable accident occurs which prevents a company from achieving first gas production by January 1, 2029, the operator may be eligible for an extension of the Sunset Date granted by the NUPRC.

f) Significance impact of the implementation of the guidelines

The Order and its implementation guidelines are expected to have a significant impact on the Nigerian oil and gas industry. The tax breaks aim to:

- i. Attract investment: By lowering tax burdens, the incentives aim to make Nigeria a more attractive destination for investment in gas exploration and development.
- ii. Boost gas production: Increased investment in NAG projects can lead to a rise in gas production, which is crucial for domestic gas supply and power generation.

- iii. Stimulate gas utilisation: Incentives for gas processing and utilisation infrastructure can encourage companies to invest in this area, reducing gas flaring and promoting efficient gas utilisation.
- g) Potential limitations in the implementation of the guidelines**
- i. **Overlapping incentives and legislative gaps:** The guidelines restrict companies eligible for GTC from receiving other incentives under the Associated Gas Framework Agreement. However, there is ambiguity around how these restrictions interact with existing and future fiscal regimes.
 - ii. **Transition challenges from gas tax credit (GTC) to gas tax allowance (GTA):** The transition mechanism from GTC to GTA is outlined for companies that achieve first gas production on or before January 1, 2029. However, the guidelines lack detailed procedures on how companies should manage this transition, especially regarding the documentation and approvals required for the switch.
 - iii. **Inadequate clarity on hydrocarbon liquid content (HCL) measurement:** The guidelines stipulate specific eligibility criteria for gas tax credits (GTC) and gas tax allowances (GTA) based on the hydrocarbon liquid content (HCL) in the produced gas. However, the method for determining HCL is only broadly outlined, relying on a dynamic measurement method unless otherwise approved by the NUPRC.
- h) Insufficient monitoring and compliance framework:** The current guidelines do not provide detailed mechanisms for regular audits and compliance checks. This oversight can lead to companies exploiting the incentives without adhering to the stipulated conditions, thus undermining the guidelines' objectives.
- i) Limited scope for capital and gas utilisation allowance (GUIA):** The GUIA applies to specific midstream gas operations but does not cover all potential capital expenditures that could drive gas utilisation. Additionally, the exemption clauses might inadvertently exclude projects that could significantly benefit from these allowances.
- j) Bureaucratic complexities and inter-agency coordination:** The implementation of the guidelines requires coordination among multiple agencies, including FIRS and NUPRC. This multi-agency involvement can lead to bureaucratic hurdles, delayed approvals, and inconsistent application of the guidelines.

28.29 Frontier exploration fund

a) Frontier exploration fund administration regulations

The objective of these regulations is to provide the general rules for the administration of the Frontier Exploration Fund pursuant to section 9 of the PIA 2021.

b) Frontier Exploration Fund Escrow Account

- i. The Commission shall, within ninety (90) days of the effective date of these Regulations, establish an escrow account called “Frontier Exploration Fund Escrow Account” (the “Escrow Account”) pursuant to section 9(4) of the Act for the purpose of managing the Frontier Exploration Fund.
- ii. The Commission shall be responsible for the administration of the Escrow Account and ensure that funds from the account are applied for the promotion of exploration and development of oil and gas resources in all the frontier basins of Nigeria.

c) The role of the Commission in respect of the Frontier Exploration Fund and promotion of exploration and development in the frontier basins

- i. The Commission shall, following the establishment of the Escrow Account ensure that NNPC Ltd make contributions of the amounts specified in Section 9(5) of the Act in the following manner:
 - With respect to production sharing contracts the amounts pursuant to subparagraph (1) shall be:
 - 30% of the proceeds from the disposal of profit oil at the fiscal price determined by the Commission.
 - 30% of the proceeds from the disposal of profit gas and the natural gas liquid derived there-from at the fiscal price determined by the Commission.
 - The Contributions by NNPC Ltd pursuant to this paragraph shall be made half yearly quarterly.
 - The Commission shall, within six months of the coming into effect of these regulations commence a Frontier basins exploration and development studies program aimed at achieving the following:
- ii. Establishing information data base of all acreages comprised in the frontier basins indicating the acreages that are licenced and the ones that are open by collecting all existing geological and geophysical data whether such data is with the National Data Repository, Nigerian Geological Survey Agency, any other governmental or private entity.
- iii. The data base shall provide information of the analysis of all geographical, geological and geophysical data relating to both licenced and un-licenced acreages in the Frontier basins.
- iv. Identifying all prospects and leads in both licenced and unlicenced areas of the frontier basins.
- v. Prioritise the prospects and leads in the frontier basins on the basis of prospectively.
- vi. The Commission may at any time where sufficient information is available request NNPC Ltd to submit a program for the drilling and exploration of the most prospective leads identified from the study, which is not subject of an approved drilling and exploration program pursuant to a licence or lease prior

to the commencement of these regulations within a time frame specified by the Commission.

- vii. Any drilling and development program submitted by NNPC Ltd in respect of any prospect or lead pursuant to paragraph 3 shall include:
 - a detailed description of the specific activities to be carried out;
 - the commencement and duration of the activities;
 - the objective and projected outcome of the activities;
 - the budget for the activities to be carried out, including the service fee proposed based on the most cost-effective methodology; and
 - the economic and financial model justifying the economic viability of the project or development of any oil and gas resources discovered as a result of the program.
- viii. With respect to any prospect or lead in the Frontier basin that the NNPC Ltd did not provide a program of drilling and development within the time specified, the Commission shall delineate such prospects and leads into licence areas and carry out a licencing round for the allocation of such licences in line with the Act and the Licencing round regulations.
- ix. The frontier basin exploration and development studies under this paragraph shall be carried out by the Commission or through the endowment of a research program for the specific purpose of enhancing hydrocarbon exploitation in a Nigerian university with relevant track record of expertise in the area. Such studies shall be financed by the Commission from the Frontier Exploration Fund pursuant to sections 9 (1) (d) and 9 (4), or through a collaboration with the Petroleum Technology Development Fund.
- x. The funding for the amounts pursuant to sub-paragraphs (5) and (6) hereof shall be from the Frontier Exploration Fund as proposed by the Commission provided that any sums to be paid from the Fund for this purpose shall be appropriated by the National Assembly prior to the commencement of the studies to which such payments relate.

28.30 Drilling of prospects or leads by NNPC Ltd

- a) Where pursuant to section 9(2) of the Act, and these regulations, the Commission request NNPC Ltd to submit a program for the drilling of any identified prospects or leads in the frontier basin, the Commission shall ensure that prior to the approval of any such program:
 - i) any prior petroleum exploration licence relating to the area containing the prospect or lead has expired or is terminated;
 - ii) the Commission has evaluated all relevant data and interpretations of the data relating to the prospects or leads;

- iii) there is no prior approval of a drilling program in relation to the prospects or leads; and
 - iv) the funds contained in the Escrow Account are sufficient to cover the estimated budget, including the service fees to be paid to NNPC Ltd under the program.
- b) Where the Commission approves a drilling program by NNPC Ltd pursuant to this paragraph, the Commission shall secure the appropriation of the budget for such program by the National Assembly before the commencement of any activity under the program. Provided that where the programme includes a multi well drilling campaign, the Commission shall reappraise such programme at the conclusion from each drilling exercise to determine whether to continue funding for the programme.
- c) NNPC Ltd prior to the commencement of the programme shall apply for a petroleum exploration licence in accordance with the Act, and shall give NNPC Limited a right of first refusal pursuant to section 9(3) of the Act.
- d) Any service fee payable to NNPC Limited pursuant to these paragraphs shall be in accordance with Section 64(k) of the Act.
- e) The budget for any approved drilling program for NNPC Ltd under this paragraph shall be paid for from the Frontier Exploration Fund consequent on prior appropriation by the National Assembly.
- f) Direct utilisation of funds from the Frontier Exploration Fund by NNPC Limited.
 - i. NNPC Ltd may, pursuant to Section 9(5) of the Act, at any time upon the establishment of the Escrow Account by the Commission present a request to the Commission in a form prescribed for approval to carry out exploration and development activities in an acreage in any of the frontier basins in Nigeria and to fund such activities from the Frontier Exploration Fund.
 - ii. A request for approval by NNPC Ltd pursuant to this paragraph may be for exploration and development activity in a frontier acreage that is not under a licence or lease.
 - iii. The Commission may approve such request and grant NNPC Ltd a Petroleum Exploration Licence pursuant to the Act and the Licencing Round Regulations where:
 - NNPC Ltd presents a detailed exploration and development program including the geological, geophysical and economic data and analysis justifying the application; and
 - the Commission is satisfied that the request merits approval.
- g) Where NNPC Ltd makes a discovery meriting appraisal pursuant to a petroleum exploration licence granted, the Commission shall require NNPC Ltd to exercise its option of a right of first refusal under the Petroleum Exploration Licence and where NNPC Ltd exercises that option, it shall comply with the requirements of the Act and the Acreage Management, Drilling and Production Regulations in respect of the acquisition of Petroleum Prospecting Licences or Petroleum Mining Leases as the case may be.

- h) Where the NNPC Ltd refuses to exercise its option of right of first refusal, the Commission shall have the right to offer the area to a third party in a licencing round.
- i) Where the Commission grants approval to NNPC Ltd pursuant to this paragraph, NNPC Ltd shall submit to the Commission a report of all of its activities relating to the approval and the Commission shall publish such report annually on its website in order to provide information relating to frontier basins to interested investors.
- j) Any petroleum prospecting licence or petroleum mining lease granted to NNPC Ltd or any third party in respect of frontier basins pursuant to these regulations shall be subject to the fiscal terms for frontier basin acreages in Nigeria under the Act.

28.31 Frontier Basin Exploration and Development Plan Committee

The Frontier Committee shall:

- a) prepare the annual FBED Plan for the approval of the Board of the Commission;
- b) prepare the financial proposal for the funding of the activities contained in the annual FBED Plan, which shall upon approval by the Board of the Commission, be the basis of the appropriation request by the Commission to the National Assembly on funding of activities in the frontier basins for the year;
- c) prepare, where directed by the Board of the Commission, additional financial proposals, which shall be the basis of any supplementary budgetary approval by the National Assembly in the year under review;
- d) prepare the guidelines for the Commission, selection criteria of third party contractors other than NNPC Limited, to perform any activity in the frontier acreages in relation to the functions of the Commission pursuant to section 9 of the Act;
- e) implement the annual FBED Plan;
- f) present to the Board of the Commission, a quarterly report on the implementation of the FBED Plan, including details of every expenditure in the quarter under review; and
- g) carry out quarterly performance review of NNPC Limited's activities and performance in relation to NNPC Limited's work programs for exploration in the frontier basins approved by the Commission.
- h) The Frontier Committee shall comprise of the:
 - i. Commission Chief Executive, who shall be the Chairman;
 - ii. Executive Commissioner, Exploration and Acreage Management;
 - iii. Executive Commissioner, Economic Regulation and Strategic Planning;
 - iv. Executive Commissioner, Development and Production;
 - v. Executive Commissioner, Health, Safety, Environment and Community;
 - vi. Commission's Secretary and Legal Adviser;
 - vii. Head of Exploration;
 - viii. Head of Acreage Management; and
 - ix. any other officer of the Commission that the Commission Chief Executive may designate in writing.

The Frontier Committee may carry out its function under these Regulations through relevant technical committees comprised of officers of the Commission as may be necessary.

- a) The Commission shall, pursuant to section 9 of the Act and these Regulations establish a Frontier Basin Data Catalogue, which shall comprise of:
 - i. existing geophysical and geological data;
 - ii. gravity data;
 - iii. electromagnetic data;
 - iv. full tension gradiometer data;
 - v. aeromagnetic data;
 - vi. non-conventional data ; and
 - vii. any other data as the Commission may determine.
- b) The Frontier Basins Data Catalogue shall be hosted in the National Data Repository and shall be in the form prescribed by the Commission.
Any data relating to the frontier basin in the custody of any government agency or acquired by third party under any licence, approval or authorisation before the coming into effect of the Act shall be included in the Frontier Basin Catalogue.
- c) The data catalogue established pursuant to sub-regulation (1) of this regulation shall provide:
 - i. the record of the surveys, logs, well reports, analysis, interpretations, reports, studies, evaluations and any other relevant information obtained on the basis of data sets contained in the catalogue;
 - ii. names of all prospects and leads in both licenced and unlicenced areas within the frontier basins;
 - iii. list of all prospects and leads based on their prospectivity and priority; and
 - iv. a technical and commercial basis required for a petroleum exploration licence to be granted to a prospective licensee to carry out exploration activities relating to any of the leads and prospects in the frontier basins.
- d) The Commission shall:
 - i. identify all prospects and leads in both licenced and unlicenced areas within the frontier basins;
 - ii. create a priority list of all the prospects and leads in the frontier acreage, on the basis of their prospectivity; and
 - iii. establish the technical and commercial basis for issuing petroleum exploration licences to prospective licensees to carry out exploration activities in the frontier basins.

28.32 Tax regime applicable to marginal field operators

Section 94 of the PIA 2021 defines a marginal field as a field or discovery which has been declared a marginal field prior to January 1, 2021 or which has been lying fallow without activity for 7 years after its discovery prior to the effective date.

Two categories of marginal fields were identified in PIA. These are:

- (a) Producing marginal fields; and
- (b) Non-producing marginal fields.

Producing marginal fields are fields already producing prior to January 1, 2021. For this type of field, the PIA allows the operators to continue under the original royalty rates and term. Automatic conversion to petroleum mining lease (PML) is required by PIA within 18 months of the enactment of PIA.

Non-productive marginal fields are fields declared marginal fields prior to January 1, 2021, but which are not producing. These fields are required by PIA to be converted to a petroleum producing licence (PPL) for onshore and shallow water acreages and which will be valid for a maximum period of 6 years (that is, initial period of 3 years and an optional extension of 3 years).

The holder of a marginal field with mining lease is expected to transfer to the government within 3 years of coming to effect of PIA, otherwise would have to provide a field development plan or farm-out the field, with the permission of the Commission.

For the field that has been transferred to the government, the Commission has the right to offer a petroleum prospecting licence (PPL) for the surrendered field under a fresh bid round.

However, the PIA no longer provides for new discovery fields to be declared as marginal fields.

28.33 Decommissioning and Abandonment Fund

Section 233 of the PIA mandates every lessee and licensee to set up, maintain and manage a decommissioning and abandonment fund to be exclusively used to pay for decommissioning and abandonment costs. It also provides that the yearly contributions to the fund will be tax deductible expense.

The PIA has committed the supervisory jurisdiction for the regulation of decommissioning and abandonment in the upstream sector to the Nigerian Upstream Petroleum Regulatory Commission (the "Commission"), while decommissioning and abandonment involving midstream and downstream operations will be regulated by the Nigerian Midstream and Downstream Petroleum Regulatory Authority (the "Authority").

Uses of the fund

- i. The decommissioning and abandonment fund shall be exclusively used to pay for decommissioning and abandonment costs.
- ii. The licensee shall have access to the fund only upon receipt of the written approval from the Authority pursuant to approval to undertake the decommissioning and abandonment programme and shall use such funds only for conducting approved decommissioning and abandonment plan.

- iii. Where there is an excess in the fund after the decommissioning and abandonment has been carried out and approved by the Authority, the excess shall be considered income for production sharing or tax purposes and the amount after the withholding of profit oil and any tax shall be returned to the licensee.
- iv. Where the fund is not sufficient to cover the decommissioning and abandonment expenditure, the licensee shall cover such difference to fulfil the obligations in full.

28.34 The Establishment, Funding, and Utilisation of the Host Community Fund

a) Introduction

The Petroleum Industry Act 2021 introduces the Petroleum Host Community Development (PHCD) under Section 234 of the Act. The Host Community Development Trust was introduced by the Act to aid in the development of the economic and social infrastructure of communities in the petroleum-producing areas and this article aims to elaborate on the establishment and procedure for host community development fund. The objectives of the Host Community under **Section 234** of the Act are as follows:

- i. to foster sustainable prosperity within host communities;
- ii. to provide direct social and economic benefits from petroleum operations to host communities;
- iii. to enhance peaceful and harmonious co-existence between licensees or lessees and host communities; and
- iv. to create a framework to support the development of host communities.

b) Regulations of the host communities development trust

The Nigerian Upstream Petroleum Regulatory Commission and the Nigerian Midstream and Downstream Petroleum Regulatory Authority are empowered under the Act to make regulations in respect to host communities on areas within their competence and jurisdiction. Such regulation includes a grievance mechanism to resolve disputes between settlers and host communities; the regulations shall include the ability to make the adjustments to reduce expenditures where the available funds for the administration are insufficient to fund the ongoing operations by doing the following:

- i) reduce the number of members of the Board of Trustees and frequency of meetings;
- ii) not fund the reserve fund nor hire fund manager;
- iii) reduce the number of members of the management committee and the frequency of meetings; and
- iv) reduce the frequency of meetings of the host community advisory committee.

- c) The Section 235 of the Act also provides for the incorporation of host communities development trusts by the settler for the benefit of host communities which the settlor is responsible for. For the purpose of setting up the trust, the settler in consultation with the host communities shall appoint and authorise a Board of Trustees to be registered by the Corporate Affairs Commission as a corporate body under the Companies and Allied Matters Act.

d) Timeline for setting up the Trust

Under **Section 236** of the Act, the Trust is required to be incorporated;

- i. within 12 months from the effective date of existing oil mining leases;
- ii. within 12 months from the effective date for existing designated facilities;
- iii. within 12 months from the effective date for existing new designated facilities under construction;
- iv. prior to the application for a field development plan for existing oil prospecting license;
- v. prior to the application for any field development plan under a petroleum prospecting license or product mining lease granted under the Act; or
- vi. prior to the commencement of commercial operations for licenses of designated facilities granted under the Act, etc.

Failure of the holder of a license or lease to comply with its obligations as stated above may be grounds for the revocation of the applicable license or lease as provided under Section 238 of the Act.

e) Objectives of the Host Community Development Trust

Section 239 of the Act provides that the Constitution of the host community development trust shall allow the host communities development trust to manage and supervise the administration of the annual contribution of the settler as contemplated under the Act and any other sources of funding. The objectives of the Trust as provided under **Section 239 (3)** are to be specified in the Constitution and it shall include the following;

- i. to finance and execute projects for the benefit and sustainable development of the host communities;
- ii. undertake infrastructural development of the host communities within the scope of funds available to the Board of Trustees for such purposes;
- iii. facilitate economic empowerment opportunities in the host communities;
- iv. advance and propagate educational development for the benefit of members of the host communities;
- v. support healthcare development for the host communities;
- vi. support local initiatives within the host communities, which seek to enhance the protection of the environment;
- vii. support local initiatives within the host communities which seek to enhance security;
- viii. invest part of the available fund for and on behalf of the host communities; and

- ix. assist in any other developmental purpose deemed beneficial to the host communities as may be determined by the Board of Trustees.

f) Sources of Funding for Petroleum Host Communities Development Trust

- i. **Section 240** of the Act states that the Constitution of each host community shall establish a fund comprising of more than one account ("host communities development trust fund") to be funded under this Act. Each settler through the operator is required to make an annual contribution of 3% of its actual operating expenditure of the proceeding financial year in the upstream petroleum operations affecting the host communities for which the applicable host community's development trust fund was established.
- ii. Each host community's development trust may also receive donations, gifts, grants, or honoraria that are provided to the communities for the attainment of its objectives.
- iii. Profits and interest accruing to the reserve fund of the host communities' development trust shall also be distributed to the applicable host communities' development trust fund.

g) Allocation of Funds for Petroleum Host Communities Development Trust

Under **Section 244** of the Act, the Board of Trustees shall in each year allocate from host communities development trust fund a sum equivalent to:

- i. 75% of the capital fund out of which the Board of Trustees shall make disbursement for projects in each of the host communities as may be determined by the management committee in furtherance of its objectives provided that any sums not utilised in a given financial year will be rolled over and utilised in subsequent years;
- ii. 20% to the reserve fund, which sums shall be invested for the utilisation of the host communities development trust whenever there is a cessation in the contribution payable by the settler; and
- iii. an amount not exceeding 5% to be utilised solely for the administrative cost of running the trust and special projects which shall be entrusted by the Board of Trustees to the settler, provided that at the end of each financial year, the settler shall render a full account of the utilisation of the fund to the Board of Trustees and where any portion of the fund is not utilised in a given year, it shall be returned to the capital fund.

The settler is required to provide to the Board of Trustees a matrix for the distribution of the trust fund to the host communities as provided under **Section 245** of the Act. Fund Managers are also to be engaged to invest in the reserve fund as the fund accrues. The financial year of the host communities' development trust shall commence on January 1, and end of December 31, of each year or date set for the purpose by the Board of Trustees as provided under **Section 253** of the Act.

28.35 Offences and penalties applicable to petroleum companies

Offences and penalties are provided for under sections 297 -301 of PIA 2021. These are:

(a) **Penalty for defaults (section 297)**

A person who fails to comply with the provisions of the Act or any regulations made under this Act for which no other penalty is specifically provided, shall be liable to an administrative penalty of ₦10 million and where the default continues beyond a period stipulated by this Act or regulation, the person shall be liable to a further administrative penalty of ₦2 million or such other sum as may by order be prescribed by the Minister of Finance, for each day the default continues.

(b) **Penalty for making incorrect account (section 298)**

A person who without reasonable excuse:

- i. prepare and submit any incorrect accounts by omitting or understating any profits or overstating any losses of which is required under the Act to make up accounts;
- ii. prepares and submit any incorrect schedule or statement required under Section 30 of the Act by overstating any expenditure or other sums; or by omitting or understating any amounts repaid, refunded, waived or released; or
- iii. provide any false or incorrect information in relation to any matter or thing affecting the liability to tax, is liable to an administrative penalty of the sum of N15 million or 1% of the amount of tax which has been undercharged in consequence of such incorrect account, schedule, statement or information or would have been so undercharged if the account, schedule, statement, or information had been accepted as correct, and is also liable for the appropriate tax which would have been charged.

a) **False statements and returns (section 299)**

When a taxpayer **fraudulently alters or prepare** false statements or returns and then filed for the purpose of obtaining tax deduction, rebate, reduction or repayment, such taxpayer is guilty of an offence.

The penalty with respect to submission of false is as follows:

- i. a fine of N15 million or 1% of the amount of tax for which the person assessable is liable under the Act for the accounting period in respect of or during which the offence was committed;
- ii. an administrative penalty of the higher of N15,000,000 and 1% of the amount of hydrocarbon tax the person is liable to in the accounting period in which the act or omission occurs;
- iii. where there is a conviction by a court of Law, irrespective of (i) and (ii) above, the person shall be liable to a fine of the higher of N15,000,000 and 1% of the

- amount of tax payable in the accounting period which the offence was committed or; six (6) months imprisonment or both fine and imprisonment; and
- iv. in addition to the penalty imposed above, such person shall pay the appropriate tax that should have been charged if the act or omission did not occur.

(d) Penalties for offences by unauthorised persons (section 300)

A person who being a member of the Service (FIRS) charged with the administration of this Act or any assistant employed in connection with the assessment and collection of the hydrocarbon tax who:

- i. demands from any person an amount in excess of the authorised assessment of the tax payable;
- ii. withholds for his own use or otherwise any portion of the amount of tax collected;
- iii. renders a false returns, whether verbal or in writing of the amounts of tax collected or received by him;
- iv. Defrauds any person, embezzles any money or otherwise uses his position to deal wrongfully with the Service or any other individuals; or
- v. not being authorised under this Act, collects or attempts to collect the tax under this Act,

commits an offence and is liable on conviction to a fine equivalent to 200% of the sum in question or to imprisonment for a term not exceeding 3 years or to both such fine and imprisonment.

(e) Tax to be payable notwithstanding any proceedings for penalties (section 301)

The institution of proceedings for or the imposition of a penalty, fine or term of imprisonment under this Act shall not relieve any person of liability to payment of any hydrocarbon tax for which he is or may become liable.

28.36 Registration and filing of returns by petroleum companies

a) Filing of returns

Section 277 of the PIA 2021 states that every company operating in the upstream petroleum sector is to prepare the following account particulars for the purpose of hydrocarbon tax computation at the end of each accounting year:

- i. Statement of accounts of its profits or losses;
- ii. Computations of its actual adjusted profit or loss and actual assessable profits of that period;
- iii. in connection with the Fifth Schedule to PIA 2021, a schedule showing:
 - the residues at the end of that period in respect of its assets,
 - all qualifying petroleum expenditure incurred by it in that period,

- the values of any of its assets disposed of in that period, and
- the allowances due to it under that schedule for that period
- iv. in connection with the Sixth Schedule to this Act, a schedule showing total production allowance from each and every field of its upstream petroleum operations related to crude oil;
- v. a computation of its actual chargeable profits for that period for the two classes of chargeable profits;
- vi. statement of amounts repaid, refunded, waived or released to it, during that period;
- vii. a computation of its chargeable tax for that period and where associated gas is being sold or otherwise delivered through the measurement point the methodology used to determine the chargeable tax;
- viii. duly completed self-assessment form attested to by the principal officer of the company; and
- ix. evidence of payment of the final instalment.

b) Submission of accounts and particulars to FIRS

Within five months after the expiration of that period or within five months after the effective date of this Act, whichever is later, a company that operates in the petroleum sector must deliver its accounts and particulars to the FIRS. A copy of the audited company's accounts and particulars of that period, shall:

- i. not estimates, contain a declaration signed by authorised officer of the company or by its liquidator, receiver or the agent of the liquidator or receiver, that the same is true and complete; and
- ii. estimates, contain a declaration, similarly signed, that the estimate was made to the best of the ability of the person signing same.

Every company which is yet to commence bulk sales or disposal of chargeable oil, shall file with the FIRS its audited accounts and returns:

- i. within 18 months from the date of its incorporation, in the case of a newly incorporated company; and
- ii. within five months after any period ending on December 31, in the case of any other company, provided that where there is an interval between December 31, of the preceding year and the date on which the company commences the bulk sale or disposal of chargeable oil, natural gas or condensate, the interval shall be deemed to form part of the preceding period.

A company which fails to comply with above provisions) is liable to pay as penalty for late filing:

- i. ~~₦~~10,000,000 on the first day the failure occurs and ~~₦~~2,000,000 for each and every subsequent day in which the failure continues; or
- ii. other sum as may be prescribed by the Minister of Finance by order published in the Federal Government Gazette.

c) Power to call for further information

The FIRS, in accordance with section 278, may give notice in writing to any petroleum company in the upstream sector requiring the company to furnish further information, within reasonable time as may be specified, in relation to any matter submission of accounts and particulars or any other matter which the FIRS may consider necessary for the purpose of this Act.

d) Power to call for returns and books

The FIRS may give notice to a company requiring it within a period not less than 21 days from the date of service of the notice, to complete and deliver to it any information called for in such notice on the date or dates as may be specified in the notice and to produce for examination any books, documents, accounts and particulars which the Service may deem fit.

Where a company assessable to hydrocarbon tax fails or refuses to keep books or accounts which, in the opinion of the FIRS are adequate for the purpose of ascertaining the tax, the FIRS may by notice in writing require it to keep such records, books and accounts as it considers to be adequate in a form and in a language as it may direct and the company shall keep the records, books and accounts as directed.

The Tax Appeal Tribunal is responsible for resolving any dispute arising from submission of books and particulars and other matters relating to it.

e) Submission of estimated return

Section 280 of the PIA 2021 specifies that not later than two months after the commencement of each accounting period, a petroleum company shall submit to the FIRS an estimated return of its profits or losses for that accounting period for the purpose of hydrocarbon tax, which shall include, computations of its estimated adjusted profit or loss and of its estimated assessable profits of that period schedule showing:

- i. the estimated residues at the end of that period in respect of its assets,
- ii. all estimated qualifying petroleum expenditure incurred by it in that period,
- iii. the values of any of its assets, estimated by references to the provisions of that schedule, to be disposed of in that period, and

- iv. the allowances due to it under that schedule for that period.

In connection with the Sixth Schedule to this Act, a schedule showing estimated total production allowance from all its upstream petroleum operations related to crude oil on field by field basis a computation of its estimated;

- i. chargeable profits of that period; and
- ii. tax for that period.

The following guidelines are also worth noting:

- i. where, at any time during the accounting period, there is a change in price, cost or volume, the company shall submit further returns on a monthly basis containing its revised estimated tax for such period;
- ii. where the further returns stated above is not made, the FIRS shall impose interest at the prevailing LIBOR or any other successor rate plus 10% points for the differential of the revised tax over the estimated tax paid by the company;
- iii. every return made by a petroleum company shall be subject to review and validation by the FIRS; and
- iv. where a company does not provide the estimates as specified above, the FIRS shall have the right to determine such estimates on the best of judgment basis and impose same on the company.

f) Extension of time for making returns

Section 281 provides that where it is shown by any company to the satisfaction of the FIRS that for some good reasons, the company is not able to comply with the time provided for submission of books and particulars the FIRS may grant in writing such extension of that time as the FIRS may consider necessary.

g) Assessment of tax payable

According to section 262, the FIRS shall proceed to assess a company with the hydrocarbon tax for any accounting period of the company immediately after the expiration of the time allowed to such company for the delivery of self-assessment.

Where a company has delivered a self-assessment for any accounting period of the company, the FIRS may:

- i. accept the self-assessment; or
- ii. refuse to accept the self-assessment;
- iii. estimate the amount of the tax to be paid by the company for that accounting period and make an assessment accordingly, provided that:

- the assessment shall not affect any liability otherwise incurred by such company by reason of its failure or neglect to deliver the accounts and particulars or to comply with the notices; and
- nothing in this subsection shall affect the right of the FIRS to make any additional assessment under the provisions of section 283 of this Act.

h) Additional assessments

Section 283 provides that where the FIRS discovers or is of the opinion at any time that, with respect to any company liable to hydrocarbon tax, tax has:

- i. not been charged and assessed upon the company; or
- ii. has been charged and assessed upon the company at an amount less than that which ought to have been assessed and charged for any accounting period of the company, the FIRS may within six years after the expiration of that accounting period:
 - assess the company, as often as may be necessary, with tax for that accounting period at such amount or additional amount as in the opinion of the 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.

Where a revision results in a greater 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. The provisions of this Act as to notice of assessment, objection, appeal and other proceedings shall apply to any such assessment or additional assessment and to the tax charged.

Where any form of fraud, willful default or neglect has been committed by or on behalf of any company in connection with hydrocarbon tax, the FIRS 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, willful default or neglect.

i) Making of assessments

Section 284 provides that assessments of hydrocarbon tax shall be made in such form and in such manner as the FIRS shall authorise and shall contain the:

- i. names and addresses of the companies assessed to tax or of the persons in whose names any companies have been assessed to tax, provided that the names of the represented companies are indicated; and

- ii. particular accounting period and the amount of the chargeable profits and chargeable tax for that period, in the case of each company for each of its accounting periods.

When any assessment is 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 showing the amended or revised amount of the chargeable profits and chargeable tax.

j) Notices of assessment

The Service shall cause to be served personally on or sent by courier to a company which is liable to hydrocarbon tax by way of an additional assessment or an assessment by the Service, a notice of assessment stating the:

- i. accounting period and the amount of its chargeable profits and chargeable tax assessed and charged upon the company;
- ii. place at which payment of the tax should be made; and
- iii. rights of the company under subsection (2).

Where there are disputes in respect of the assessment, the person may apply to the Service by notice of objection in writing, to review and revise the assessment made on him and the application shall be made within 30 days from the date of service of the notice of the assessment, stating the amount of chargeable:

- i. chargeable profits of the company of the accounting period in respect of which the assessment is made; and
- ii. chargeable tax and the tax which such person claims should be stated on the notice of assessment.

The FIRS, upon being satisfied that due 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 30 days, shall extend the period as may be reasonable in the circumstances. After receipt of a notice of objection, the FIRS may within such time and place as it shall specify, require the person giving the notice of objection to furnish such particulars as the FIRS may deem necessary:

Where an applicant for revision fails to agree with the FIRS on the amount of the hydrocarbon tax, the FIRS shall:

- i. give such applicant notice of refusal to amend the assessment as desired by the applicant; or

- ii. may revise the assessment to such amount as the FIRS may determine and give the applicant notice of the revised assessment and tax payable. If disputes persist, the issue will be resolved through the resolution provided in the PIA 2021.

28.37 Dispute resolution mechanisms provided in the PIA 2021

With respect to disputes, the Act prescribes two distinct fora for resolving disputes arising from the operations of the Act –the Federal High Court [FHC] and the Tax Appeal Tribunal (TAT). In addition, both the Nigerian Upstream Regulatory Commission (Commission) and the Nigerian Midstream and Downstream Petroleum Regulatory Authority [Authority] have powers to resolve certain disputes arising from the operations of the Act.

- (a) By virtue of section 251, particularly 251(1) (n) of the Nigerian Constitution, the Federal High Court (FHC) has exclusive jurisdiction in relation to matters/disputes arising from mines and minerals (including oil fields, oil mining, geological surveys and natural gas). Therefore, the general rule is that any dispute arising from the operations of the Act should be submitted to the FHC for adjudication.

(b) The Tax Tribunal

The second forum of resolving disputes is the TAT which is specific to tax disputes with FIRS. This is a novelty under the Act as under the PPTA, tax disputes should, in the first instance, be resolved by the Body of Appeal Commissioners [BAC], the predecessor to the TAT. However, the Court of Appeal in *Cadbury v. FBIR* held that the BAC was unconstitutional because it usurped the jurisdiction of the FHC, under section 251 of the Constitution, because appeals from the BAC went directly to the Court of Appeal². The BAC was subsequently replaced by the TAT via the Federal Inland Revenue Service (Establishment) Act (FIRSEA).

So, before the introduction of the PIA, taxpayers filed appeals to the TAT in line with FIRSEA. Section 288 of the Act now reflects current practice since there is no longer a BAC.

Specific examples under the Act

PwC (2021) specifies the following examples:

Disputes arising from ownership and compensation to legal occupier / owner of land

One of the instances in which an aggrieved person may file an action at the FHC is under section 101. The section precludes licensees and lessees from entering, occupying or exercising any rights conferred by their licenses / leases over certain sacred, protected or previously occupied land without the written permission of the Commission. Licensees and leases who intend to enter or occupy such land must first write to the Commission specifying the land proposed to be occupied, the purpose for such occupation and amount of compensation paid or proposed to be paid to the legal occupier of the land.

Section 101(1) (d) further provides that in the event of any dispute arising from who the legal occupier is and / or the amount of the compensation payable, the licensee /lessee would be required to deposit with the FHC (within the jurisdiction of the location of the land) a sum to be determined by FHC as reasonable compensation payable to the rightful owner or occupier of the land.

The Petroleum Industry Act (PIA) of 2021 outlines a dispute resolution framework primarily focused on the oil and gas sector in Nigeria. This framework includes both Alternative Dispute Resolution (ADR) methods like mediation and arbitration, as well as the establishment of the Alternative Dispute Resolution Centre (ADRC) to administer these processes. In essence, the PIA's dispute resolution mechanism aims to provide a comprehensive and efficient system for handling disputes in the Nigerian oil and gas sector, prioritizing ADR methods to reduce the burden on the courts and promote quicker, more cost-effective resolutions.

Disputes arising from refusal to grant, renew, modify or extend applications

Another instance in which the Act prescribes the FHC as the court of competent jurisdiction is with respect to matters relating to license applications. Under section 111, the Authority is vested with powers to grant, renew, modify or extend individual permits and licences. Where an applicant is not satisfied with the reasons for the refusal of its application, it may appeal to the FHC for judicial review. As distinct from an appeal, in a judicial review, the court's remit is to review the process, rather than the decision itself, by which a decision was reached to assess whether that decision was wrong by some flaw. The court will not impose what it thinks is the "correct" decision. Whilst there is no similar provision relating to the grant of licenses by the Commission, such powers may also be subject to judicial reviews.

Disputes between licensees, lessees or permit holders and the Commission or Authority

Section 218(7) vests the FHC with exclusive jurisdiction over disputes between licensees, lessees or permit holders and the Commission or Authority. This is in line with the exclusive jurisdiction of the FHC under the Constitution.

28.38 Worked examples

28.38.1 Questions

1. Dopemu Petroleum Limited was granted an oil mining lease (OML) in January 2001 for exploration of oil and gas in onshore and shallow water operations for twenty years and a further renewal of twenty years, if application is made.

At the expiration of the initial license in December 31, 2021, the company decided not to apply for extension of its current license under the Petroleum Profit Tax regime and opted for automatic conversion on January 1, 2022, to the petroleum mining lease (PML) as enshrined in the Petroleum Industry Act 2021.

The following details were extracted from the financial statements of the company for the year ended December 31, 2022:

(i) **Revenue:**

Category	Type	Quantity Actual		Fiscal	
		(million barrels)	Price \$	Price \$	
Crude oil sold	Bonny light	7.5	75	77	
	Forcados				
	medium	5.2	69	70	
Condensate from associated gas sold	ABC condensate	4	55	54	
Gas liquid from associated gas sold	XYZ liquid	3.8	48	50	

(ii) **Expenses/expenditure:**

Item	<u>N</u> 'million
Royalty incurred and paid for	118,900
Production cost	112,660
Concession rentals	25,200
Repairs of plant, machinery and fixtures	2,680
First exploration well costs	2,770
Repairs of production implement utensils	1,850
Cost of gas reinjection wells	1,250
NDDC charge	200
Purchase of information on existence of petroleum deposits	305
Customs duties	106
First two appraisal wells costs	3,900

Decommissioning and abandonment	1,500
Depreciation	2,820
Environmental remediation fund	1,800
State government ground rent fee	22
Finance costs	25
Host community costs	1,400
Miscellaneous expenses	1,129
Administrative costs	1,980

The following additional information was also made available:

- (i) First two appraisal wells costs consisted of 60% tangible costs and 40% intangible costs.
- (ii) Expenditure for the purchase of information on existence of petroleum deposits included:

	N'million
Acquisition of geophysical information	100
Geological data and information	120
Others	<u>85</u>
	<u>305</u>

- (iii) Miscellaneous expenses were:

	N'million
Gas flare fee	720
Donations to orphanage homes	132
Terminalling cost	169
Stamp duty	18
Signature bonus paid for the acquisition of petroleum deposits	<u>90</u>
	<u>1,129</u>

- (iv) Agreed capital allowances for the year was ~~N~~4,500 million.
- (v) Production allowances after commencement of the Act:

	N'million
Onshore operations	800
Shallow water operations	<u>1,100</u>
	<u>1,900</u>

- (vi) Assume that ~~N~~440 is equivalent to US \$1 and tax liabilities payable will be in local currency (Naira).

Required:

Compute the following for the relevant assessment year:

- (a) Hydrocarbon tax liability
- (b) Income tax liabilities

2. Dada Petroleum Company Limited has been operating in the onshore and shallow water areas of the Niger Delta region for over fifteen years. The company was granted a petroleum mining lease licence in January 2021.

In its bid to improve profitability, the company's management intends to apply for licence to operate in the deep sea area as from 2025. The decision of the management is expected to be laid before the members of the company at the 2023 annual general meeting, which comes up in the second half of 2024.

The following was extracted from the book of accounts of the company for the year ended December 31, 2023:

Income:	N' million	N' million
Fiscal value of crude oil sold (note 1)		191,100
Value of condensate from associated gas sold (note 1)		84,474
Value of natural gas liquid from associated gas sold (note 1)		55,328
Other incidental income		151
Realised exchange gain		38
Gross total income		331,091
Expenses/deductions:		
Royalty incurred and paid	86,200	
First exploration wells cost	6,800	
First two appraisal wells costs	18,700	
Joint cost- terminalling	12,000	
Gas reinjection wells cost	3,420	
Salaries and wages	9,300	
Power cost	1,650	
NDDC charge	125	
Concessional rentals	60,430	
Depreciation of assets	13,860	
Allowance for doubtful debts (note 3)	2,400	
Host community trust fund contribution	4,800	

Stamp duty	16	
Staff welfare	350	
Travelling	180	
Donations and subscription (note 4)	6	
Decommissioning and abandonment	1,300	
Environment remediation fund contribution	1,250	
General expenses (note 5)	500	
Finance costs	<u>1,750</u>	<u>225,037</u>
Net profit		<u>106,054</u>

The following additional information was also provided:

- (i) Data on crude oil; condensate from associated gas sold; and natural gas liquid from associated gas sold;

Category	Quantity	Actual	Fiscal price
Crude oil	5.25	70	72
Condensate from associated gas	3.61	45	44
Natural gas liquid from associated gas	2.80	38	40

- (ii) Omitted from the records was a balancing charge of ₦1, 500,000 made from disposal of an old oil equipment platform;

- (iii) Allowance for doubtful debts:

	₦' million
Specific provisions	900
General provisions	<u>1,500</u>
	2,400

- (iv) Donations and subscription:

	₦' million
Recognised orphanage homes	3.0
Host community's cultural group	2.0
Subscription to oil and gas association	<u>1.0</u>

6.0

(v) General expenses:

N' million

Penalty for gas flare	250
Printing of stationery items	140
State government levy	<u>110</u>
	<u>500</u>

(vi) Agreed capital allowances:

N' million

Brought forward	167
For the year	<u>2,105</u>
	<u>2,272</u>

(vii) Production allowance:

N' million

Onshore operations	900
Shallow water operation	<u>1,700</u>
	<u>2,600</u>

(viii) The exchange rate averaged N520 to 1 USD during the year.

(ix) Assume the tax liabilities are to be paid in domestic (Naira) currency.

Required:

As the company's Tax Manager, you are to advise the management, in accordance with the provisions of Petroleum Industry Act 2021, on:

- (a) Hydrocarbon tax payable in the relevant assessment year
- (b) The tax implications, if the company decides to involve or invest in deep offshore areas

3. Okpala Petroleum (Nigeria) Limited is a subsidiary company of a foreign oil and gas

company. The company has been involved in petroleum prospecting and exploration (upstream) for both local and foreign sales for over twenty years.

As a corporate board policy, the management meets and considers the report in respect of its operations on quarterly basis. The results for the first quarter (January – March) 2024 of the company, as prepared by the Finance Controller, revealed the following:

	N'000	N'000
Income:		
Value of oil sold (export)		900,380
Value of oil sold (local)		
Value of gas sold		430,100
Other income		<u>7,200</u>
Gross revenue		1,560,980
Expenses:		
Production cost	210,730	
Tangible drilling cost for the first appraisal well	18,800	
Intangible drilling cost for the first appraisal well	17,600	
Cost of gas reinjection wells	4,000	
Cost of drilling 3 appraisal wells	24,000	
Rent	13,000	
Royalties on export sales	69,300	
Royalties on local sales	9,800	
Salaries and wages	170,500	
Head office shared costs	62,000	
Repairs and maintenance	8,930	
Customs duty on essentials	2,900	
Depreciation	66,000	
Interest on loans	4,400	
Allowance for doubtful debts	34,000	

Administrative expenses	79,200	
Stamp duties on increase in share capital	1,000	
Bank charges	900	
Miscellaneous expenses	22,500	
Income tax provision	90,000	
Tertiary education tax provision	<u>6,000</u>	<u>915,560</u>
Net profit		<u>645,420</u>

The following additional information was provided:

(i) The monthly fiscal oil and gas prices at each measurement point have been approved on an export parity basis by the Nigerian Upstream Petroleum Regulatory Commission.

(ii) Head office shared costs included:

	N'000
Research and development costs	12,000
Indirect production costs	<u>50,000</u>
	<u>62,000</u>

(iii) Repairs and maintenance expenses were made up of:

	N'000
Repairs of oil pipelines and storage tanks	6,000
Repairs of plant	1,500
Improvement to the company's building	<u>1,430</u>
	<u>8,930</u>

(iv) Allowance for doubtful debts included:

	N'000
Specific provision	10,000
General provision	20,000
Bad debt written off	<u>4,000</u>
	<u>34,000</u>

(v) Administrative expenses consisted of:

	N'000
Natural gas flare fees	10,000
Transport cost	13,200
Cost of obtaining information on existence of oil	7,300
Expenditure for acquisition of geological information	14,900
Other allowable expenses	<u>33,800</u>
	<u>79,200</u>

(vi) Miscellaneous expenses included:

	N'000
Tenement levy paid to the local government	2,000
Contribution to Niger Delta Development fund	5,500
Contribution to Host Community Development fund	12,000
Donation made to widows and orphans association	<u>3,000</u>
	<u>22,500</u>

(vii) Unabsorbed losses brought forward from previous years were N35,000.

Required:

As the company's Assistant Tax Manager, you have been asked by the Tax Manager to submit a report to him for review in the next three days as the Management Committee meeting is slated for next week. The report should specify:

- a) The adjusted profit and assessable profit of the company for the first quarter of 2024 in line with the provisions of Petroleum Industry Act 2021.
- b) Comments on the cost-price ratio of the company in view of the provisions of the Sixth Schedule to Petroleum Industry Act 2021.

4. In the last three years, some major oil producing companies had decided to divest their investments from the Nigerian oil and gas sector. One of the reasons for this might be the new global energy order, which seems to favour the evolution of "green environment" as against the present use of hydrocarbons with its inherent environmental degradation and pollution.

Similarly, in response to the yearnings of various stakeholders in the oil and gas sector, the Federal Government had enacted the Petroleum Industry Act (PIA) 2021. Generally, the Act provides the legal, governance, regulatory and fiscal

framework for the Nigerian petroleum industry, the development of host communities and for related matters.

Notable commentators and professionals in the sector did suggest that the divestment of major oil and gas operators in Nigeria could be beneficial to the local investors if funds are sourced and deployed to businesses in the sector. Mergers and Acquisition of indigenously-owned oil producing companies had been noted as one of valuable options in this regard.

Required:

- a) In respect of Petroleum Industry Act 2021, identify the expenses allowable in the computation of adjusted profit of a company in upstream petroleum operations?
- b) Identify and explain SIX implications of mergers and acquisitions in respect of a situation where a new company takes over an existing company.

28.38.2 Suggested solutions to questions

1. (a)

Dopemu Petroleum Limited
Computation of hydrocarbon tax liability
For 2022 assessment year

	<u>N'million</u>	<u>N'million</u>
Revenue:		
Value of crude oil sold:		
Bonny light (7.5m barrels x \$77 x ~~N440~~)		254,100
Forcados medium (5.2m barrels x \$70 x ~~N440~~)		160,160
Value of condensate from associated gas sold(4m barrels x \$55 x ~~N440~~)		96,800
Value of gas liquid from associated gas sold(3.8m barrels x \$50 x ~~N440~~)		<u>83,600</u>
Gross revenue		594,660
Balancing charge		=
Total gross income		594,660
Allowable deductions (Section 263):		
Royalty incurred and paid for	118,900	
Production cost	112,660	
Concession rentals	25,200	
Repairs of plant, machinery and fixtures	2,680	
First exploration well	2,770	
Repairs of production implement utensils	1,850	
Cost of gas reinjection wells	1,250	
NDDC charge	200	

Purchase of information (~~₦305~~ – ~~₦85~~)	220	
First two appraisal wells cost	3,900	
Decommissioning and abandonment	1,500	
Environmental remediation fund	1,800	
State government ground rent levy	22	
Host community costs	1,400	
Misc. (~~₦1,129~~ – ~~₦720~~ – ~~₦132~~ – ~~₦90~~)	<u>187</u>	
Total allowable cost	<u>274,539</u>	(274,539)
Total costs subject to CPR limit (Wk 1)	<u>279,039</u>	
Excess allowable cost carried forward	Nil	
Adjusted profit		320,121
Less: Loss relief		=
Assessable profit		320,121
Less: Section 266 and 6 th Schedule deductions: Capital allowances		<u>4,500</u>
		315,621
Less: Production allowances:		
Onshore operations	800	
Shallow water operations	<u>1,100</u>	<u>1,900</u>
Chargeable profit		<u>313,721</u>
Hydrocarbon tax @30% of ~~₦~~313,721m		94,116.30

Workings on cost price ratio

	<u>N'million</u>	<u>N'million</u>
A. Gross revenue		594,660
(i) Maximum allowable @ 65%		<u>386,529</u>
Total operating cost		274,539
Capital allowances		<u>4,500</u>
B. Total eligible costs		279,039
Less: Exempted costs incurred (Section 263(1)):		
Royalty paid	118,900	
NDDC charge	200	
Concession rentals	25,200	
Host community funds	1,400	
Environmental remediation fund	<u>1,800</u>	
C1. Total exempted cost		<u>147,500</u>
(ii) Net total costs to be subject to CPR (B -C1)		<u>131,539</u>
C2. Maximum allowable cost is the lower of (i) and (ii), which is		<u>131,539</u>
D, Total allowable cost (in line with the practice of FIRS)		
= C1 + C2 (that is,exempted cost + CPR restricted cost)		
= N147,500 + N131,539 = N279,039.		

(b) **Dopemu Petroleum Limited**
Companies income tax liabilities
For 2023 assessment year

	<u>N'million</u>	<u>N'million</u>
Gross total income		594,660

Less:

Section 263 allowable deductions

CITA allowable deductions: 274,539

Administrative cost 1,980

Finance costs 25

Donations to orphanage 132 2,137 276,676

Assessable profit 317,984

Add: Balancing charge Nil

317,984

Less: Loss relief Nil

317,984

Less: Capital allowances 4,500

Total profit 313,484

Companies income tax @ 30% of total profit

94,045.20

Tertiary education tax @ 2.5% of

Assessable profit 7,949.60

101,994.80

2.

Dada Petroleum Company Limited
Computation of hydrocarbon tax
For the year ended December 31, 2023

	<u>N'</u> million	<u>N</u> million
Income/Revenue:		
Value of crude oil sold (5.25m barrels x \$72 x N520)		196,560
Value of condensate from associated gas sold (3.61m barrels x \$45 x N520)		84,474
Value of natural gas liquid from associated gas sold (2.8m barrels x \$40 x N520)		<u>58,240</u>
Gross revenue		339,274
Balancing charge		<u>1.5</u>
Total gross income		339,275.5
Allowable deductions (Section 263):		
Royalty incurred and paid	86,200	
First exploration wells cost	6,800	
First two appraisal wells cost	18,700	
Joint cost-terminalling	12,000	
Gas reinjection wells cost	3,420	
NDDC charge	125	
Concessional rents	60,430	
Host community trust fund contribution	4,800	
Stamp duty	16	
Decommissioning and abandonment	1,300	
Environment remediation fund contribution	1,250	

General expenses- State government levy	<u>110</u>	
Total allowable costs	<u>195,151</u>	<u>(195,151)</u>
Total cost subject to CPR limit (W1)	<u>197,423</u>	
Excess allowable cost carried forward	<u>Nil</u>	

Adjusted profit		144,124.5
Less: Loss relief		<u>Nil</u>
Assessable profit		144,124.5
Less: Section 66 and 6 th Schedule deduction		
Capital allowances:		
Brought forward	167	
For the year	<u>2,105</u>	<u>2,272</u>
		141,852.5
Less: Production allowances:		
Onshore operations	900	
Shallow water operations	<u>1,700</u>	<u>2,600</u>
Chargeable profit		<u>139,252.5</u>
Hydrogen tax @30% of ₦139,252.5		<u>41,775.75</u>

Workings 1: Cost-profit-ratio (CPR)		₦' million	₦' million
A.	Gross revenue		<u>339,274</u>
(i)	Maximum allowable @65% of gross revenue		<u>220,528.10</u>
	Total operating cost		195,151
	Capital allowances		<u>2,272</u>
B.	Total eligible costs		197,423
	Less: exempted cost incurred (Section 263):		
	Royalty paid	86,200	

	NDDC charge	125	
	Concessional rentals	60,430	
	Host community fund	4,800	
	Environmental remediation fund	<u>1,250</u>	
C1	Total exempted cost		<u>152,805</u>
(i)	Net total cost to be subject to CPR (B – C1)	<u>44,618</u>	
C2	Maximum allowable cost is the lower of (i) and (ii), which is ~~N~~ 44,618,000.		
D.	Total allowable cost (in line with the practice of FIRS)		
	= C1 +C2 (that is, exempted cost + CPR restricted cost		
	= ~~N~~ 152,805 million + ~~N~~ 44,618 million		
	= ~~N~~ 197,423 million.		

b. The tax implications on the profit/activities of the company, if it invests in deep offshore areas are:

- (i) Hydrocarbon tax will not apply to companies with investments in the deep offshore areas; and
- (ii) The company will need to incorporate a separate company to take care of the deep offshore activities. This means that onshore/shallow water operations cannot be merged with deep offshore activities.

3. Okpala Petroleum (Nigeria) Limited

Internal Memo

Date:

From: Assistant Tax Manager

To: Tax Manager

RE: Report on the Company's Adjusted Profit and Assessable Profit for the 2024 Year of Assessment and Comments on Cost-price Ratio

I refer to your request on computations of adjusted profit and assessable profit for the first quarter of 2024 and wish to comment on the company's cost-price ratio for the period under review. I hereby present a report for your perusal before same is presented at the next management committee meeting.

(a) **Computation of adjusted profit and assessable profit**

The provisions of section 262 (ascertainment of crude oil revenue, adjusted profit, assessable profit and chargeable profits), 263 (allowable deductions) and 264 (disallowable deductions) were complied with in the computations of adjusted profit and assessable profit of the company. Using two formats (as shown in appendices I and 2), the company's adjusted profit revealed ~~N~~941,350,000. When the unabsorbed loss of ~~N~~35,000 was relieved, the assessable profit for the year was ~~N~~941,315,000.

(b) **Comments on cost - price ratio**

The Petroleum Industry Act 2021 provides that all costs presented under Section 263 and under the Sixth Schedule to the Act in an accounting period, the sum of which is eligible for deduction under the hydrocarbon tax shall be subject to a cost-price ratio limit of 65% of gross revenue determined at the measurement points.

However, certain costs such as rent, royalty and contributions to the environmental remediation fund, host community fund, Niger Delta Development Commission fund and other similar contributions are excluded from this provision.

Any such cost not deductible shall be carried forward to subsequent years for deduction provided the amount to be deducted shall not exceed the total cost incurred.

Thank you.
Festus Akintola

Appendix 1: Computation of adjusted profit and assessable profit for the first quarter of 2024 (Format 1)

	N'000	N'000
Net profit as per accounts		645,420
Add back: Disallowable deductions (Section 264)		
Cost of drilling appraisal wells (1/3 of N24,000)	8,000	
Head office shared costs	62,000	
Repairs and maintenance (building improvement)	1,430	

Customs duty on essentials	2,900	
Depreciation	66,000	
Interest on loans	4,400	
Allowance for bad debts	34,000	
Administrative expenses:		
Natural gas flare fees	10,000	
Cost of obtaining information on oil	7,300	
Bank charges	900	
Miscellaneous expenses:		
Donation to widows and orphans	3,000	
Income tax provision	90,000	
Tertiary tax provision	<u>6,000</u>	<u>295,930</u>
Adjusted profit		941,350
Less: Unabsorbed losses b/f		<u>(35)</u>
Assessable profit		<u>941,315</u>

Appendix 2: Computation of adjusted profit and assessable profit for the first quarter of 2024 (Format 2)

	N'000	N'000
Gross income		1,560,980
Less: Allowable expenses (Section 263 deductions)		
Production cost	210,730	
Tangible drilling cost	18,800	
Intangible drilling cost	17,600	
Cost of gas reinjection wells	4,000	
Cost of drilling appraisal wells (2/3 of N24,000)	16,000	

Rent	13,000	
Royalties:		
Export sales	69,300	
Local sales	9,800	
Salaries and wages	170,500	
Repairs and maintenance (N8,930 – N1,430)	7,500	
Administrative expenses		
(N13200 + N14,900 +N33,800)	61,900	
Stamp duties on increase in share capital	1,000	
Miscellaneous expenses (N22,500 – N3,000)	<u>19,500</u>	<u>619,630</u>
Adjusted profit		941,350
Less: Unabsorbed losses b/f		<u>(35)</u>
Assessable profit		<u>941,315</u>

4.(a) Section 263(1) of Petroleum Industry Act 2021 provides that in computing the adjusted profit of a company in upstream petroleum operations related to crude oil for any accounting period, the following expenses are allowable:

- (i) Rents incurred by the company for the period pursuant to a petroleum mining lease or petroleum prospecting licence;
- (ii) All royalties the liability for which was incurred and were paid by the company during the period in respect of crude oil and associated gas and where a petroleum mining lease includes payment to the Federation Account related to production sharing, profit sharing, risk service contracts or other contractual features under a model contract and the company has incurred liability for such payments in kind or in cash;
- (iii) Expenses directly incurred for repair of plant, machinery or fixtures employed for the purpose of the business;
- (iv) An expenditure tangible or intangible directly incurred in connection with the drilling of the first exploration well and the first two appraisal wells in the same field;
- (v) Any amount contributed to a fund, scheme or arrangement approved by the Commission for the purpose of decommissioning and abandonment, provided

that the surplus or residue of the fund shall be subject to tax under this Act at the end of the life of the field, where such surplus is returned to the lessee;

- (vi) All sums the liability of which was incurred by the company to the Federal Government or any State or Local Government Council by way of levies, stamp duties and fees;
 - (vii) Costs of gas re-injection wells, which are re-injecting natural gas that otherwise would be flared, subject to ratification by the Commission; and
 - (viii) Any amount contributed to any fund, scheme or arrangement approved by the Commission pursuant to the establishment of host communities development trusts, Environmental Remediation Fund, Niger Delta Development Commission and other similar contributions.
- (b) Implications of mergers and acquisitions in respect of a situation when a new company takes over an existing company are:
- (i) Filing of annual returns: The new company that emerges from a merger process is expected to file the audited accounts and returns with the FIRS within 18 months from the date of its incorporation or not later than 6 months after the end of its first accounting period, whichever is earlier.
 - (ii) Basis of assessment: The commencement rules will apply to the new company.
 - (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 allowance 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 unutilised capital allowances may be added to the tax written down value of the assets taken 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.
 - (vi) Merger cost: The FIRS may seek to disallow expenses (legal and professional fees) incurred in the process of merger 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 (but subject to statutory limit, for instance, for compensation for loss of employment is N100 million- Finance Act 2020).

MINING TAXATION

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29.0 Learning objective

The objective of this chapter is to enhance readers' understanding of mining taxation in Nigeria.

29.1 Learning outcomes

At the end of this chapter, students are expected to know:

- a. the administration procedure of mining business in Nigeria;
- b. the incentives available for mining operation in Nigeria;
- c. the minerals titles;
- d. the environmental considerations and rights of host communities;
- e. the offences and penalties;
- f. the computation of capital allowances;
- g. the process of computing total profits;
- h. the treatment of losses; and
- i. the scope and administration of the Nigeria Extractive Industries; and Transparency Initiative (NEITI).

29.2 Administrative structure

The administrative structure of Nigeria's mining industry has undergone significant changes, particularly with the split of the Ministry of Mines and Steel Development into two separate ministries: the Ministry of Solid Minerals Development (MSMD) and the Ministry of Steel Development (MSD).

a) Ministry of Solid Minerals Development (MSMD)

i) Introduction

The MSMD is responsible for unlocking the economic potential of the solid minerals sub-sector in Nigeria. Its key responsibilities include:

- Policy formulation: Advising the government on laws and regulations guiding prospecting, quarrying, and mining.
- Regulation: Issuing permits, licenses, and leases, and collecting rents, fees, and royalties.
- Information and knowledge: Providing data to enhance investment in the sector

ii) Departments under MSMD

Some of the departments under MSMD include:

- Mines Inspectorate Department: Ensures compliance with mining regulations.
- Mines Environment and Compliance: Oversees environmental issues related to mining.

- Mining Cadastre Office: Manages the registration and licensing of mining claims.
- Artisanal and Small-scale Mining Department: Supports small-scale miners.
- Human Resources: Manages personnel and staffing needs.
- Finance and Accounts: Handles financial matters.

iii) Parastatals under MSMD

The MSMD has several parastatals, including:

- Nigerian Geological Survey Agency (NGSA): Provides geological data and information.
- Nigerian Institute of Mining and Geo-Sciences: Offers training and research in mining and geosciences.
- Council of Nigerian Mining Engineers and Geo-scientist (COMEG): Regulates mining professionals.
- National Raw Materials Exploration Agency (NSRMEA): Explores and develops raw materials.

b) Ministry of Steel Development (MSD)

The MSD focuses on accelerating the development of Nigeria's steel industry. However, the specific departments and parastatals under MSD are not well-defined, its primary mandate is to Nigeria's steel industry has significant potential for economic growth and industrialisation,

The administrative system of steel development in Nigeria involves various government agencies, parastatals, and private sector organisations. Here's an overview:

- Ministry of Steel Development:** The government ministry responsible for formulating policies and strategies to promote the development of the steel industry.
- Steel Development Parastatals:** Organisations like the Nigerian Steel Development Authority (NSDA) may be responsible for implementing policies, regulating the industry, and promoting steel development.
- Steel Companies:** Public and private steel companies, such as Ajaokuta Steel Company and Delta Steel Company, play a crucial role in steel production and development.
- Administrative Structure.** This may include:
 - **Policy formulation:** The Ministry of Steel Development formulates policies to guide the steel industry's growth and development.
 - **Regulation:** Regulatory bodies ensure compliance with industry standards, safety protocols, and environmental regulations.

- Industry promotion: Government agencies and parastatals promote the steel industry through initiatives like investment promotion, research and development, and human capacity building.
- Monitoring and evaluation: The government tracks progress, identifies challenges, and evaluates the impact of policies and programs.

29.3 Administration of the Nigerian minerals

The administrative structure and functions of principal stakeholders are as below:

a) Functions of the Minister

Subject to the provision of the mining Act, the Minister shall:

- i) ensure the orderly and sustainable development of Nigeria's mineral resources;
- ii) develop a well-planned and coherent programme of exploitation of mineral resources taking into account the economic development, ecological and environmental factors;
- iii) monitor compliance with community development agreements by industry operators;
- iv) establish the procedure for monitoring developments in the solid minerals sector and encourage the private sector investment in mineral resources development;
- v) ensure that in the exploitation of the mineral resources, an equitable balance is maintained between foreign and indigenous interest;
- vi) 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;
- vii) accelerate the development of technical and professional manpower required in the mineral sector;
- viii) establish environmental procedures and requirements applicable to mining operations;
- ix) 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;
- x) prescribe measures for the general welfare and safety of workers engaged in mineral resources operations;
- xi) develop a geo-scientific databank, and collate detailed data concerning the identity, quantity of Nigeria's mineral resources;
- xii) assist the private sector in identifying specific mining projects;
- xiii) 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;
- xiv) provide and disseminate up to date information on incentives in mineral resources available to investors under this Act;

- xv) register and keep records of all enterprises and companies established and pursuing activities in mineral resources and allied projects;
- xvi) cause to be created, such departments and agencies as are necessary for the effective administration of this Act;
- xvii) introduce investment-friendly local contents measures for mining projects;
- xviii) facilitate the development of indigenous technical and professional manpower required in the mineral resources sector;
- xix) co-operate on behalf of the Federal Government with other governments and international agencies in respect of matters relating to Nigeria's mineral resources;
- xx) do such other things as are reasonably necessary or expedient for the performance of his functions under this Act; and
- xxi) 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.

b) Establishment of the Mining Cadastre Office

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.

i) The Mining Cadastre Office:

- shall be a body corporate with perpetual succession and a common seal;
- may sue and be sued in its corporate name; and
- may acquire, hold and dispose of property, whether movable or immovable.

ii) 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.

iii) In order to fulfil its functions under this Act the Mining Cadastre Office shall operate as the sole agency responsible for the administration of mineral titles.

iv) The Mining Cadastre Office shall in addition to any other functions prescribed by or under this Act perform the following:

- consider applications for mineral titles and permits, issue, suspend and upon the written approval of the Minister, revoke any mineral title;
- receive and dispose of applications for the transfer, renewal, modification, relinquishment of mineral titles or extension of areas;
- maintain a chronological record of all applications for mineral title in;
- a priority book which is to be specifically used to ascertain the priority and registration of applications for exclusive rights on vacant areas;

- a general registry book which is to be used for all other types of applications where registration of the priority is not required; and
- undertake such other activities reasonably necessary for the purpose of carrying out its duties and responsibilities under the provisions of this Act.

(c) 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.

(d) 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:

- i) a register of reconnaissance permits;
- ii) a register of exploration licences;
- iii) a register of mining leases;
- iv) a register of small-scale mining leases;
- v) a register of the water use permits; and
- vi) a register of quarry leases.

(e) Priority

- i) 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.
- ii) 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.
- iii) The Mining Cadastre Office shall provide a receipt to an applicant for mineral title evidencing:
 - all documents and fees received from the applicant in respect of the application; and
 - the date and time of the application.

(f) Competitive bidding

- i) The Minister shall by regulations determine areas wherein an exploration licence and a mining lease shall be granted based on competitive bidding requirements.

- ii) 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:
- 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;
 - the financial and technical resources of the applicant; and
 - the previous experience of the applicant in the conduct of reconnaissance and mining operations.
 - The successful application shall be treated as an application under section 59 or 65.

(g) Fees payable to the Mining Cadastre Office

The Mining Cadastre Office shall collect:

- i) a fee for processing of applications for mineral titles; and
- ii) an annual service fee established at a fixed rate per square cadastral unit for administrative and management services rendered by the Cadastre Office.

(h) 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.

(i) 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.

(j) 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.

(k) 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 authorised 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.

(l) 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.

(m) Establishment of departments

For the purposes of carrying out his functions under this Act, the Minister shall establish in the Ministry:

- i) a Mines Inspectorate Department;
- ii) a Mines Environmental Compliance Department;
- iii) such other departments as he may consider expedient for the proper administration of this Act;
- iv) 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;
- v) 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.

(n) 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:

- i. exercise general supervision over all reconnaissance, exploration and mining operations to ensure their compliance with this Act;
- ii. supervise and enforce compliance by mineral titleholders with all mine health and safety regulations prescribed under this Act and any other law in force;
- iii. prepare and render records, reports and returns as required by the Minister or as prescribed by Regulations;
- iv. take custody of mineral resources required by any Court to be forfeited to the government;
- v. with the prior approval of the Minister, dispose of any mineral resources forfeited to the government;
- vi. carry out investigations and inspections necessary to ensure that all conditions relating to mineral titles and the requirements of this Act are complied with;
- vii. discharge such other duties as may be assigned from time to time, by the Minister; and
- viii. review and recommend to the Minister, programmes for controlling mining operations.

(o) 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:

- i. review all plans, studies and reports required to be prepared by holders of mineral title in respect of their environmental obligations under this Act;
- ii. 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;
- iii. 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
- iv. liaise with relevant agencies of Government with respect to the social and environmental issues involved in mining operations, mine closure and reclamation of land.

(p) Establishment of State Mineral Resources and Environmental Management Committee

- i. 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”.
- ii. The Committee in each state shall consist of:
 - a representative of the Mines Environmental Compliance Department in the Ministry who shall be the chairman of the Committee;
 - a representative of the Ministry responsible for land matters or mineral related matters in the state;
 - the Mines Officer responsible for the state;
 - a representative of the Ministry of Agriculture or Forestry in the state;
 - a representative of the Surveyor-General of the state;
 - a representative of the Local Government Council when matters affecting the said Local Government Area are being considered by the Committee;
 - a representative of the State Environmental Department or Agency; and
 - a representative of the Federal Ministry of Environment in the State.

(q) Functions of the Mineral Resources and Environmental Management Committee

The Committee is to:

- i. consider and advise the Minister on issues affecting returns of necessary reports affecting grants of mining titles;
- ii. consider issues affecting compensation and make necessary recommendations to the Minister;
- iii. discuss, consider and advise the Minister on the matters affecting pollution and degradation of any land on which any mineral is being extracted;

- iv. consider such other matters relating to mineral resources development within the State as the Minister may, from time to time, refer to the Committee;
- v. 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;
- vi. advise the Local Government Areas and communities on the implementation of programs for environmental protection and sustainable management of mineral resources;
- vii. advice and other necessary assistance required by holders of mineral titles in their interaction with State Governments,
- viii. Local Government Councils, communities, civil institutions, and other stakeholders;
- ix. advise the Minister in resolving conflicts between stakeholders; and
- x. advise the Minister in respect of matters connected with the implementation of this Act.

r) The Committee shall:

- i) meet at least once every three months and at such times as the Minister may deem necessary;
- ii) regulate its own procedure;
- iii) 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;
- iv) the Committee shall forward its report to the Minister after each meeting;
- v) 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;
- vi) the Chairman and three other members shall form a quorum at a meeting of the Committee;
- vii) every meeting of the Committee shall be presided over by the Chairman or, in his absence, by the Mines Officer for the state;
- viii) if on any question to be determined there is an equality of votes, the Chairman shall have a casting vote; and
- ix) the Committee shall have the power to determine its own procedure.

s) Delegation of powers by the Minister

- i. The Minister may, by notification in the Gazette, delegate to any department or
- ii. 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.
- iii. 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.

- iv. The failure of the mineral titleholder to provide access to an officer for the purposes of inspection under subsection (2) shall constitute an offence.

t) 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.

u) Use of land for mining a priority

- i) 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.
- ii) 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.

29.4 Mining incentives

The key incentives available to companies engaged in mining operations are summarized below:

a) 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 capitalised 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 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.
- 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.
- 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.

b) 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 ₦1million within 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 the 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% while above N100,000 will attract 30%

- 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).

29.5 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.

a) According to Sec.46 of the Mining Act:

The right to search for or exploit mineral resources is obtained through one of the following mineral titles in the form of:

- i. a reconnaissance permit;
- ii. an exploration licence;
- iii. a small-scale mining lease;
- iv. a mining lease;
- v. a quarry lease; and
- vi. a water use permit.

b) 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.

- c) 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.
- d) The form of all mineral titles shall be prescribed.

29.6 Possession and purchase of minerals

- a) According to section 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 tributaries.
- b) According to section 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:
 - i) 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
 - ii) the person holds a permit to possess or purchase that mineral issued under the provisions of this Act; or
 - iii) 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".
- c) According to S.94 "No person shall purchase any mineral unless he holds a licence to purchase minerals issued under this Act".
- d) 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 centre" and valid sales receipts obtained and when centres required shall be produced for inspection by an authorised officer of the Cadastre Office".
- e) 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.

29.7 Environmental considerations and rights of host communities

- a) According to section 120 (1), the environmental protection and rehabilitation programme required under the provisions of the Act shall:
 - i. provide for specific rehabilitation and reclamation actions, inspections, 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 programs provided for in section 119 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.
- f) In the case of its approval, the Mines Environmental Compliance Department shall ensure the implementation of the environmental protection and rehabilitation programme.

29.8 Allowable and disallowable expenses

- a) All direct cost of mining and transportation are all allowable expenses.
- b) All allowable expenses as we have under CITA for corporate mining company.
- c) All allowable expenses as we have under PITA for individuals into mining business.

29.9 Rates of capital allowances

Summary of capital allowances for a mining company is provided below:

Description	Initial allow (%)		Annual allow (%)	
	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

29.10 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 29.1

The tax written down value of qualifying capital expenditure for Olowogbowo Mining Limited for year ended December 31, 2022 are as stated below:

S/N	QCE	TWDV	(₦)	Remarks
1.	Mining expenditure	195,000		3rd year of use
2.	Furniture and fittings	860,000		2 years remaining
3.	Motor vehicle	3.2m		3 years remaining

Additional information

- i. On April 1, 2023, ₦73m mining expenditure was incurred.
- ii. On October 1, 2023, furniture costing ₦900,000 was acquired.

Required

Compute capital allowances for 2024 and 2025 assessment years.

Solution to illustration 29.1

	Mining expenditure	Furniture and fitting	Motor vehicle	Capital allowance
IA (%)	95	25	50	
AA (%)	0	20	25	
	₦	₦	₦	₦
2024 (1/1/23– 31/12/23)				
TWDV	195,000	860,000	3, 200,000	
AA	-	430,000	1,066,667	1,496,667
CA				1,496,667
2025(1/1/24– 31/12/ 24)				
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	<u>1,631,657</u>
CA				<u>8,506,657</u>
TWDV/NV	<u>545,000</u>	<u>540,010</u>	<u>1,066,667</u>	

29.11 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 Tertiary education tax on assessable profit as stated earlier.

29.12 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).

29.13 Assessment of tax liability

Tax shall be computed on the total profit for the relevant tax year on preceding basis. Where the turnover is less than N25M (small company – tax is at 0%) from N25M but less than N100M – 20% (medium-sized company) and from N100M and above – 30% (large company).

29.14 Offences and penalties

a) According to section 131, a person who:

- i. conducts exploration or mines minerals or carries out quarrying operations otherwise than in accordance with the provisions of the Act;
- ii. in making application for mineral title, knowingly makes a statement which is false or misleading in any material particular;
- iii. 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
- iv. removes, possesses or disposes of any mineral contrary to the provisions of this Act commits an offence.

b) According to section 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.

- i) Any person who applies a loan granted pursuant to Part III of this Act in contravention of subsection (1) 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.
- ii) 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.

- c) According to section 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 ₦20,000.00 in respect of each day during which the offence continues.
- d) According to section 134, a person who:
 - I. 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
 - II. 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.
- e) According to section 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.
- f) According to section 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:
 - i. Where a person who makes a false representation as in subsection of this section is a holder of another mining title, that mining title shall be revoked.
 - ii. 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.
- g) According to section 137, a person who without lawful authority wilfully 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.
- h) According to section 138 (1), any person who without lawful cause;
 - i. interferes with or obstructs any mining or quarrying operation authorised by or under this Act; or
 - ii. 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.

- i) A person who commits an offence under section 137 and subsection (a) of this section is liable on conviction:
 - i. 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
 - ii. at a second or subsequent offence, to imprisonment for a term not exceeding 5 years or below 2 years.
 - iii. 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 N10,000.00 in respect of each day or part of a day during which the offence continues.
- j) According to section 139 (1), where an offence under this Act or under the regulations made there under is committed by a body of persons:
 - (i) 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;
 - (ii) in the case for a partnership, every partner or officer of that body shall be deemed to be guilty of that offence.

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.
- k) According to section 140 (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.
- l) In this section and the other provisions of this Act, officers:
 - i) in relation to a body corporate, includes a director, chief executive, manager and secretary; and
 - ii) 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.
- m) According to section 141:
 - i) 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;
 - (ii) 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;

- iii) 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; and
- iv) according to section 142, an offence under this Act and the regulations made.

29.15 The Nigeria Mineral Resources Decision Support System (NMDSS)

This is a framework designed to support informed decision-making in the solid minerals sector.

29.15.1 Overview/key features

- a) Data management: NMDSS collects, stores, and manages data on mineral resources, exploration, mining, and related activities.
- b) Data analysis: The system analyses data to provide insights on mineral potential, mining activities, and industry trends.
- c) Decision support tools: NMDSS provides tools and models to support decision-making on mineral exploration, mining, and investment.
- d) Stakeholder engagement: The system facilitates collaboration and information sharing among stakeholders, including government agencies, mining companies, and local communities.

29.15.2 Benefits

- a) Informed decision-making: NMDSS provides accurate and timely data to support informed decision-making in the solid minerals sector.
- b) Improved transparency: The system promotes transparency in mineral resource management and mining activities.
- c) Increased efficiency: NMDSS streamlines data management and analysis, reducing the time and cost associated with decision-making.
- d) Better resource management: The system helps optimise mineral resource utilisation and management.

29.15.3 Components

These are as follows:

- a) Geospatial data: NMDSS incorporates geospatial data on mineral resources, geology, and mining activities;
- b) Mining cadastre: The system includes a mining cadastre to manage mining licenses, permits, and other regulatory information;
- c) Economic analysis: NMDSS provides economic analysis tools to evaluate the financial viability of mining projects;

- d) Environmental impact assessment: The system assesses the environmental impact of mining activities.

29.15.4 Objectives

- a) Promote sustainable mining: NMDSS aims to promote sustainable mining practices and responsible mineral resource management.
- b) Attract investment: The system provides a transparent and efficient framework to attract investment in the solid minerals sector.
- c) Improve governance: NMDSS enhances governance and accountability in the solid minerals sector.

In conclusion, the Nigeria Mineral Decision Support System is designed to support the growth and development of the solid minerals sector, while promoting sustainable mining practices and responsible resource management.

29.16 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;

29.16.1 Establishment of the national stakeholders working group

- a. The governing body of the NEITI shall be the National stakeholders working group (in this Act referred to as “the NSWG”).
- b. 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.
- c. 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.

29.16.2 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.

29.16.3 Tenure of Office of NSWG

A person appointed as a member of the NSWG shall hold Office for 4 years and no more.

29.16.4 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.

29.16.5 Meetings of the NSWG

- a. 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.
- b. 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.
- c. 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.
- d. 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.
- e. 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.

29.16.6 Quorum

The quorum of the NSWG at any meeting shall be 8 members.

29.16.7 Special committees

The NSWG may constitute such special committees as it considers fit to deal different aspects of its responsibilities.

29.16.8 Appointment of Executive Secretary, consultants and other staff of the NSWG

- a) The NSWG may create departments and engage the services of such staff and consultants as it may consider necessary for the NEITI.
- b) The NEITI shall have an Executive Secretary who shall:
 - 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;
 - be responsible for the day to day administration of the NEITI; and
 - serve as Secretary to NSWG.
- c) The staff and consultants of the NEITI may be engaged on such terms and conditions as the NSWG may determine.
- d) The NSWG shall fix the remunerations, allowances and benefits of the staff and consultants of the NEITI.
- e) The NSWG shall recommend to the President for appointment, qualified validators in line with NEITI guidelines as contained in second schedule to this Act.
- f) NSWG shall fix the remunerations, allowances and benefits for the validators.

29.17 Benefits and challenges for companies adopting sustainability practices

Companies adopting sustainability practices in Nigeria can reap several benefits and may also face some unique challenges.

a) Benefits

- i. Long-term competitive advantage: companies that prioritise sustainability tend to enjoy a competitive edge in the market.
- ii. Improved employee motivation: sustainability practices can boost employee morale and productivity.
- iii. Increased profitability: sustainable companies can experience increased profitability through cost reduction and improved reputation.
- iv. Enhanced reputation: adopting sustainability practices can improve a company's reputation, attracting investors and customers.
- v. Better resource management: sustainability practices promote efficient use of resources, reducing waste and environmental impact.

b) Challenges

- i. Inconsistent regulations: Nigeria's regulatory environment can be unpredictable, making it challenging for companies to implement sustainability practices.
- ii. Limited awareness: Some companies may lack awareness about the benefits and importance of sustainability practices.
- iii. Financial constraints: Implementing sustainability practices can require significant investment, which can be a challenge for some companies.
- iv. Infrastructure deficiencies: Nigeria's infrastructure challenges, such as power supply and transportation, can hinder sustainable practices.
- v. Varied industry practices: Sustainability reporting and practices can vary across industries, making it essential for companies to develop sector-specific strategies.

c) Industry-specific observations

- i. Banking and oil and gas sectors: These sectors tend to prioritise sustainability reporting more than other industries in Nigeria.
- ii. Company size and profitability: Larger and more profitable companies are more likely to adopt sustainability practices.
- iii. Auditor type: Companies audited by Big-4 audit firms tend to have a more significant positive relationship with sustainability reporting.

29.18 Environmental, social, and governance (ESG) considerations

ESG issues are crucial in Nigeria's extractive industry, particularly in oil, gas, and solid minerals. Thematic areas include:

a) Environmental aspects

- i. Pollution control: Managing pollution from extractive activities, such as oil spills and chemical contamination.
- ii. Biodiversity conservation: Protecting ecosystems and biodiversity in areas where extractive activities occur.
- iii. Climate change Mitigation: Reducing greenhouse gas emissions and promoting sustainable practices.
- iv. Waste management: Properly managing waste generated from extractive activities.

b) Social aspects

- i. Community engagement: Engaging with local communities, respecting their rights, and addressing their concerns.
- ii. Human rights: Respecting human rights, including those of indigenous peoples and vulnerable groups.

- iii. Social impact assessment: Conducting assessments to identify potential social impacts and developing mitigation strategies.
 - iv. benefit Sharing: Ensuring that local communities benefit from extractive activities.
- c) Governance aspects**
- i. Transparency and accountability: Promoting transparency in extractive industry operations and ensuring accountability for actions.
 - ii. Corruption prevention: Preventing corruption and ensuring that revenues from extractive activities are managed transparently.
 - iii. Regulatory framework: Establishing and enforcing a robust regulatory framework to govern extractive industry activities.
 - iv. Stakeholder engagement: Engaging with stakeholders, including government, civil society, and local communities.
- d) Challenges**
- i. Environmental degradation: The extractive industry can lead to environmental degradation, including pollution and habitat destruction.
 - ii. Social conflicts: Extractive activities can lead to social conflicts, including disputes over land rights and benefit sharing.
 - iii. Corruption: Corruption can undermine governance and accountability in the extractive industry.
 - iv. Lack of transparency: Lack of transparency can make it difficult to track revenues and ensure accountability.
- e) Opportunities**
- i. Sustainable development: The extractive industry can contribute to sustainable development if managed responsibly.
 - ii. Economic growth: The industry can generate significant economic benefits for Nigeria.
 - iii. Job creation: Extractive activities can create jobs and stimulate local economies.
 - iv. Improved governance: Implementing strong ESG practices can improve governance and accountability in the industry.
- f) Best Practices**
- i. Implementing ESG Standards: Companies should implement robust ESG standards and practices.
 - ii. Stakeholder engagement: Regular engagement with stakeholders, including local communities and civil society.
 - iii. Transparency and reporting: Transparent reporting on ESG performance and progress.

- iv. capacity building: Building capacity within government and local communities to manage extractive activities.

By prioritising ESG considerations, Nigeria's extractive industry can contribute to sustainable development, economic growth, and improved governance.

29.19 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).

29.20 Worked examples

29.20.1 Questions

1. The diverse composition of the National Stakeholders Working Group (NSWG) ensures broad stakeholder representation and promotes transparency and accountability in Nigeria's extractive industries.

Required:

Discuss the composition and tenure of office of NSWG.

2. It is an understatement to say that Nigeria, as a nation, sits on gold. There are mineral deposits over the land waiting to be harnessed. Recovering of deposits is highly capital intensive. Foreign funds, technicalities and technology are needed and these are not readily and easily accessible. A veritable source aside foreign investment could be in the form of a term or special loan designated for long term project.

The Central Bank of Nigeria sometimes guarantees such arrangements through any of the financial institutions. Worthy of note is the fact that repayment must be guaranteed. The principle is that the point to which the fund is committed must be able to pay back the principal and interest as and when due. For this reason, the investing unit will be interested in certain factors that will guarantee the performance of the facility to be granted.

Required:

Discuss the incentives available to would-be investors in the mining industry in Nigeria.

3. In Nigeria, extractive industry – oil, gas and solid minerals – the relevance of the environmental, social and governance (ESG) cannot be over emphasised. It deals with those matters of interests to all the stakeholders and promotes the basis for good relationship amongst all concerned.

Required:

Discuss those specific relevant matters that make up the ESG.

4. Better Life Mining and Exploration Limited is in the business of mining of solid mineral which it exports to Europe for over fifteen years. For the year ended December 31, 2024 the following financial records were presented:

	₦'000	₦'000
Export		856,000
Local sales		<u>136,700</u>
Gross turnover		992,700
Mining cost	256,950	
Transportation cost	63,240	
Rent	108,800	
Bad debt	133,560	
Directors fees	80,000	
Auditors remuneration	50,000	
Insurance	35,000	
Balance of preliminary expenses	25,000	
Income tax provision	78,000	
Donations and subscription	20,000	
Depreciation	101,930	
Motor vehicle expenses	<u>45,560</u>	<u>(998,040)</u>
Net loss		<u>(5,340)</u>

The following additional information was provided:

- i) It has been established that both the mining and transportation cost are relevant direct cost.

- ii) Included in the donation is N8,500,000 given to a religious women society of which the General Manager's wife is the chairperson.
- iii) Analysis of the bad debt account shows the following:

	N' 000
General allowance for doubtful debt cf.	83,560
Specific allowance for doubtful debt cf	48,000
Bad debt written off	20,000
Bad debt written off recovered	<u>(18,000)</u>
	<u>133,560</u>

- iv) Capital allowances agreed with relevant tax authorities were:

	N'000
Brought forward	38,500
For the year	95,000

Required:

- a) Advise on the tax liability for the relevant tax year.
- b) Comment on the significant tax incentives being enjoyed by operators in the Nigerian mining sector.

29.20.2 Suggested solutions to questions

1. Composition of the NSWG

The NSWG shall be constituted by the President and shall consist of a Chairman and not 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.

- 2.** The key incentives available to companies engaged in mining operations - section 5 (2.1) of the Mining Act
- (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.

- (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.

3. Specific relevant matters that make up the environment, social and governance (ESG)

a) Environmental aspects

- i. Pollution control: Managing pollution from extractive activities, such as oil spills and chemical contamination.
- ii. Biodiversity conservation: Protecting ecosystems and biodiversity in areas where extractive activities occur.
- iii. Climate change mitigation: Reducing greenhouse gas emissions and promoting sustainable practices.
- iv. Waste Management: Properly managing waste generated from extractive activities.

b) Social aspects

- i. Community engagement: Engaging with local communities, respecting their rights, and addressing their concerns.
- ii. Human rights: Respecting human rights, including those of indigenous peoples and vulnerable groups.
- iii. Social impact assessment: Conducting assessments to identify potential social impacts and developing mitigation strategies.
- iv. Benefit sharing: Ensuring that local communities benefit from extractive activities.

c) Governance aspects

- i. Transparency and accountability: Promoting transparency in extractive industry operations and ensuring accountability for actions;
- ii. Corruption prevention: Preventing corruption and ensuring that revenues from extractive activities are managed transparently;
- iii. Regulatory framework: Establishing and enforcing a robust regulatory framework to govern extractive industry activities;
- iv. Stakeholder engagement: Engaging with stakeholders, including government, civil society, and local communities.

d) Environmental considerations and rights of host communities

- i. According to section 120 (1), the environmental protection and rehabilitation program required under the provisions of the Act includes:
 - provision for specific rehabilitation and reclamation actions, inspections, and annual reports;

- reasonable estimate of the total cost of rehabilitation;
 - cost estimates for each specific rehabilitation and reclamation action; and
 - 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.
- ii. The Mines Environmental Compliance Department shall exercise all its powers in respect of environmental protection and rehabilitation programmes provided for in section 119 in consultation with the State Mineral Resources and Environmental Management Committee established pursuant to section 19 of this Act;
 - iii. 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;
 - iv. 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.
 - v. In the case of a rejection of the environmental protection and rehabilitation programme by the Mines Environmental Compliance Department, the mineral title holder may:
 - 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
 - if its application is rejected twice, the holder may submit the matter to arbitration within thirty days of notification of the decision, under subsection of this section; and
 - vi. In the case of its approval, the Mines Environmental Compliance Department shall ensure the implementation of the environmental protection and rehabilitation programme.

4(a)

Better Life Mining and Exploration Limited
Computation of tax liabilities
For 2025 assessment year

	N'000	N'000
Net loss per accounts		(5340)
Add back:		
Donation to religious group	8,500	
Bad debt excess provision (W1)	42,560	

Preliminary expenses	25,000	
Income tax provision	78,000	
Depreciation	<u>101,930</u>	<u>255,990</u>
Adjusted profit		250,650
Less: Capital allowances:		
Brought forward	38,500	
For the year	<u>95,000</u>	<u>133,500</u>
Total profit		<u>117,150</u>

Companies income tax at 30% of total profit

35,145

Tertiary education tax @3% of assessable profit

7,519.50

Computation of minimum tax

N'000

Gross turnover	992,700
Less: franked investment income	<u>Nil</u>
Turnover for minimum tax computation	<u>992,700</u>
Minimum tax @ 0.5% of ~~N~~ 992,700,000	<u>4,963.50</u>

Since actual companies income tax (~~N~~35,145,000) is greater than the minimum tax (~~N~~4,963,500), the company is liable to pay the actual companies income tax (~~N~~35,145,000).

b) Tax incentives available to a mining company in Nigeria

- i. Such companies enjoy generous capital allowance i.e 95% initial allowance.
- ii. They are exempted from tax in the first three years of operations.
- iii. Provided the company's turnover does not exceed N25 million, they enjoy all the benefits of small businesses.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) IN EXTRACTIVE INDUSTRY

Contents

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30 Environmental, Social, and Governance (ESG) in Extractive Industry

30.0 Learning objective

The learning objective of this chapter is for readers to know and appreciate the importance of environmental, social and governance (ESG) in extractive industry.

30.1 Learning outcomes

On successful completion of this chapter, readers should be able to explain the:

- (a) background and the need for environmental, social and governance;
- (b) relevance of ESG compliance;
- (c) challenges and opportunities;
- (d) benefits of ESG compliance;
- (e) history of events that necessitated ESG;
- (f) penalties for noncompliance to government directives on ESG; and
- (g) standards of the Extractive Industries Transparency Initiatives (EITI).

30.2 Background and need for environmental, social, and governance (ESG)

Environmental, social, and governance (ESG) considerations have become increasingly important in the business world due to growing concerns about sustainability, social responsibility, and good governance. A brief background and need for ESG are as below.

3.2.1 Background

Growing awareness of environmental issues: Climate change, pollution, and resource depletion have raised concerns about the impact of business activities on the environment.

Social and human rights concerns: Issues like labour exploitation, human rights abuses, and community displacement have highlighted the need for businesses to prioritise social responsibility.

Governance failures: corporate scandals and governance failures have emphasised the importance of transparency, accountability, and good governance practices.

30.2.2 Regulatory bodies

- (a) National Environmental Standards and Regulations Enforcement Agency (NESREA): Responsible for enforcing environmental regulations.
- (b) Department of Petroleum Resources (DPR): Regulates the oil and gas industry.

- (c) Nigerian Extractive Industries Transparency Initiative (NEITI): Promotes transparency and accountability in the extractive industry.

30.2.3 Need for ESG

- a) Risk management: ESG considerations can help businesses identify and manage risks related to environmental, social, and governance issues.
- b) Long-term sustainability: ESG practices can contribute to long-term sustainability and resilience; ensuring businesses remain viable and successful over time.
- c) Stakeholder expectations: Investors, customers, employees, and communities increasingly expect businesses to prioritise ESG considerations and demonstrate responsible practices.
- d) Regulatory requirements: Governments and regulatory bodies are implementing ESG-related laws and regulations, making compliance essential for businesses.
- e) Reputation and brand value: Strong ESG practices can enhance a company's reputation and brand value, while poor practices can lead to reputational damage and financial losses.

30.3 Relevance of ESG compliance

ESG compliance is crucial in Nigeria's extractive industry, which includes oil and gas, mining, and other natural resource extraction activities. A comprehensive overview is discussed below.

30.3.1 Environmental compliance

- a) Regulatory framework: Nigeria has laws and regulations governing environmental protection, such as the Environmental Impact Assessment (EIA) Act, the National Environmental Standards and Regulations Enforcement Agency (NESREA) Act, and the Petroleum Act.
- b) Environmental impact assessments (EIA): Companies must conduct EIAs to identify potential environmental risks and develop mitigation strategies.
- c) Waste management: Proper disposal of waste, including hazardous materials, is essential to prevent environmental pollution.
- d) Oil spill response: Companies must have plans in place to respond to oil spills and mitigate their impact on the environment.
- e) Biodiversity conservation: Companies must take steps to protect and conserve biodiversity in areas where they operate.

30.3.2 Social compliance

Community engagement: Companies must engage with local communities, respect their rights, and address their concerns.

- (a) Human rights: Companies must respect human rights, including the rights of indigenous peoples and vulnerable groups.
- (b) Livelihood restoration: Companies must restore livelihoods affected by their operations, providing fair compensation and support.
- (c) Social investment: Companies are expected to invest in social projects that benefit local communities, such as education, healthcare, and infrastructure development.
- (d) Cultural Heritage Protection: Companies must take steps to protect and preserve cultural heritage sites and artefacts.

30.3.3 Governance compliance

- a) Transparency and accountability: Companies must be transparent in their operations, financial reporting, and decision-making processes.
- b) Corruption prevention: Companies must have anti-corruption policies and procedures in place to prevent bribery and other forms of corruption.
- c) Regulatory compliance: Companies must comply with relevant laws, regulations, and industry standards.
- d) Stakeholder engagement: Companies must engage with stakeholders, including government agencies, civil society organisations, and local communities.
- e) Board oversight: Companies must have effective board oversight to ensure ESG compliance and responsible business practices.

30.4 Benefits and challenges of sustainable practices for companies

The benefits of sustainable practices for companies include the following:

- (a) Enhanced reputation: Companies that prioritise sustainability often enjoy a positive public image, attracting customers and investors who value environmental and social responsibility.
- (b) Cost savings: Sustainable practices can lead to reduced operational costs through energy efficiency, waste reduction, and resource conservation.
- (c) Increased Innovation: Embracing sustainability can drive innovation, leading to the development of new products, services, and business models.
- (d) Risk management: Companies that proactively address environmental and social issues can mitigate risks related to regulatory compliance, supply chain disruptions, and reputational damage.
- (e) Access to capital: Investors are increasingly considering environmental, social, and governance (ESG) factors in their decisions, making it easier for sustainable companies to access funding.
- (f) Talent attraction and retention: Employees are more likely to be attracted to and remain with companies that demonstrate a commitment to sustainability, fostering a motivated and engaged workforce.

The challenges of sustainable practices for companies include:

- a) High initial costs: Implementing sustainable practices often requires significant upfront investment in technology, infrastructure, and training.
- b) Complexity of supply chains: Ensuring sustainability across complex global supply chains can be challenging, particularly in industries with multiple tiers of suppliers.
- c) Regulatory compliance: Navigating varying regulations and standards across different regions can be complex and resource-intensive.
- d) Stakeholder alignment: Achieving alignment among diverse stakeholders, including investors, customers, employees, and regulators, can be difficult.
- e) Measuring impact: Accurately measuring and reporting on sustainability initiatives can be complex, requiring robust data collection and analysis systems.
- f) Balancing short-term and long-term goals: Companies may face pressure to balance short-term financial performance with long-term sustainability objectives.

The above challenges can be mitigated through the following:

- (a) Strategic planning: Develop a clear sustainability strategy aligned with business goals.
- (b) Stakeholder engagement: Engage with stakeholders to understand their expectations and concerns.
- (c) Investment in technology: Leverage technology to improve efficiency and reduce costs.
- (d) Collaboration and partnerships: Collaborate with suppliers, industry peers, and NGOs to share best practices and drive industry-wide change.
- (e) Continuous monitoring and evaluation: Regularly assess and report on sustainability performance to identify areas for improvement.
- (f) By understanding the benefits and challenges of sustainable practices, companies can make informed decisions and develop effective strategies to drive long-term success while contributing to a more sustainable future.

30.5 Benefits of ESG compliance

- a) Improved reputation: ESG compliance can enhance a company's reputation and build trust with stakeholders.
- b) Increased Investment: Companies that demonstrate strong ESG practices may attract more investment and funding.
- c) Reduced risk: ESG compliance can help companies manage risks and avoid costly fines and penalties.
- d) Sustainable Development: ESG compliance can contribute to sustainable development and improve the well-being of local communities.
- e) By prioritising ESG compliance, companies in Nigeria's extractive industry can reduce their environmental footprint, promote social responsibility, and ensure good governance.

- f) Improved financial performance: Studies have shown that companies with strong ESG practices tend to perform better financially in the long term.
- g) Increases companies goodwill: ESG practices can build trust and credibility with stakeholders, enhancing a company's reputation and brand value.
- h) By prioritising ESG considerations, businesses can ensure long-term sustainability, build trust with stakeholders, and contribute to a more equitable and environmentally conscious world.

30.6 Best practices

International Standards: Companies can adopt international standards, such as the Extractive Industries Transparency Initiative (EITI), the International Finance Corporation's (IFC) Performance Standards, and the United Nations Guiding Principles on Business and Human Rights.

Stakeholder engagement: Regular engagement with stakeholders can help companies understand their concerns and expectations.

Capacity building: Building capacity within companies and government agencies can improve ESG compliance and enforcement.

Reporting and disclosure: Companies should publish regular reports on their ESG performance and disclose information on their operations, financial performance, and sustainability initiatives.

30.7 History of events that necessitated ESG

The history of ESG considerations is a rich and evolving narrative that spans several decades. A brief overview is as below:

30.7.1 Early beginnings

1960s- Environmental Movement: The publication of Rachel Carson's book "The Silent Spring" in 1962 marked the beginning of the environmental movement, highlighting the detrimental effects of pesticides on the environment and human health. This sparked a growing awareness of corporate accountability for environmental and social impacts.

1970s - Socially Responsible Investing (SRI): SRI emerged as a way for investors to align their portfolios with their values, focusing on social issues like human rights and supply chain ethics. The Pax World Funds, established in 1971, was the first publicly available mutual fund in the US to consider social and environmental factors in investment decisions.

30.7.2 Key milestones

1987- Brundtland Commission: The United Nations' World Commission on Environment and Development (WCED) defined sustainable development as "meeting the needs of the present without compromising the ability of future generations to meet their own needs."

1992- Rio Earth Summit: The United Nations Environment Program (UNEP) issued the Statement of Commitment by Financial Institutions on Sustainable Development, recognising the role of the financial sector in promoting sustainability.

1994- Triple Bottom Line (TBL): John Elkington introduced the TBL concept, a sustainability framework balancing people, planet, and profit.

1997- Global Reporting Initiative (GRI): The GRI was founded to address environmental concerns, later broadening its scope to social and governance issues.

30.7.3 Modern ESG era

2004 - "Who Cares Wins" Report: The UN Global Compact released a report illustrating how to integrate ESG factors into company operations, officially coining the term "ESG."

2006 - Principles for Responsible Investment (PRI): The PRI was launched to understand investment implications of ESG factors and promote sustainable investments.

2010s - ESG Reporting and Standardisation: Efforts to standardize ESG reporting and metrics gained momentum, with organisations like the Sustainability Accounting Standards Board (SASB) developing industry - specific accounting rules.

2023 - ISSB IFRS S1: General requirements for disclosure of sustainability-related financial information. This was issued by the International Sustainability Standard Board (ISSB) and the IFRS Foundation. This is to require entities to disclose information about their sustainability-related risks and opportunities that are useful to users of general purpose financial reports in making informed decisions about providing resources to the entity. The information should however be material to the entity's cash flows and long-term viability, particularly those arising from ESG factors.

2023 - ISSB IFRS S2: Climate-related disclosures. The primary objective of this standard is to require entities to disclose relevant information in respect of their climate-related risks and opportunities that is useful to users of general-purpose financial reports for making informed resource allocation decision, particularly in the area of access to capital and overall business model.

Since the activities of companies in the extractive industry (such as oil and gas, mining of solid minerals) have significant impact on environment and climate-related issues in areas of their operations, it is expected that these companies comply with various reporting standards that are necessary for stakeholders to take informed decision.

30.8 Penalties for non-compliance to government directives on ESG

Penalties for non-compliance with government directives on Environmental, Social, and Governance (ESG) can be significant and varied. Here are some potential consequences:

(a) Financial penalties

- (i) Monetary fines: These can vary based on company size and type.
- (ii) SEC fines: In the developed countries non-compliance with ESG disclosures is a serious crime. In the USA for instance, the Securities and Exchange Commission (SEC) has imposed significant fines for ESG-related non-compliance.
- (iii) In Nigeria, the Climate Change Act 2021 establishes a legal framework to address climate change, including achieving net-zero emissions by 2050-2070. The Act also introduces a carbon tax. It imposes obligations on businesses to provide for reduction in carbon missions and also designate an environmental sustainability officer. Failure to comply can result in fines. Also, non-compliance with data protection regulations while processing ESG data can lead to fines and penalties.

(b) Legal consequences

- (i) Litigation risks: Non-compliance can lead to costly legal battles and potential settlements.
- (ii) Regulatory scrutiny: Companies may face stringent audits and investigations, potentially resulting in operational disruptions.
- (iii) Loss of operating licenses: In severe cases, non-compliance can lead to loss of operating licenses or restrictions on business operations

(c) Reputational damage

- (i) Loss of trust: Stakeholders, including investors and customers, may lose trust in companies that fail to comply with ESG regulations, leading to reputational damage.

- (ii) Negative publicity: Non-compliance can result in negative media coverage, further damaging a company's reputation.
- (iii) Competitive disadvantage: Companies that prioritise ESG compliance may gain a competitive edge over non-compliant businesses.

(d) Operational challenges

- (i) Inefficiencies: Non-compliance can lead to operational inefficiencies and reduced innovation.
- (ii) Supply chain disruptions: Companies may face supply chain disruptions if their partners or suppliers are not ESG-compliant.
- (iii) Future business opportunities: Non-compliance can limit future business opportunities, as many government bodies and large corporations require ESG compliance from their partners.

30.9 The standards of the Extractive Industries Transparency Initiative (EITI)

30.9.1 EITI principles and requirements

The Extractive Industries Transparency Initiative (EITI) Standard is a global benchmark for transparency and accountability in the extractive industry (oil, gas, and mining sectors). The standards outline requirements for countries implementing EITI and cover several key areas:

- (a) EITI principles: Fundamental aims and commitments agreed upon by all stakeholders, focusing on transparency, accountability, and good governance;
- (b) Disclosure requirements: EITI implementing countries must disclose information along the extractive industry value chain, including:
 - (i) Revenue collection: Disclosing revenue collected from extractive activities;
 - (ii) Revenue allocation: Transparent allocation of revenues to different government entities and projects;
 - (iii) Contracts and licenses: Disclosure of contracts, licenses, and beneficial ownership information;
 - (iv) Production: Information on production levels and volumes;
 - (v) Social and economic spending: Disclosure of social and economic expenditures, including quasi-fiscal expenditures;
 - (vi) Beneficial ownership: Disclosure of beneficial owners of extractive companies to prevent corruption and ensure transparency;
 - (vii) State-owned enterprises: Strengthening accountability of state participation in extractive industries;
 - (viii) Commodity trading: Transparency in commodity trading transactions;
 - (ix) Open data policy: Recommendations for publishing open data to facilitate public access and analysis;

- (x) Governance and oversight: Establishing clear roles and responsibilities for multi-stakeholder groups, boards, and secretariats; and
- (xi) Validation and compliance: Regular assessments to ensure countries meet EITI requirements and maintain high standards of transparency and accountability

30.9.2 The 2023 EITI Standard

The 2023 EITI Standard includes new and refined provisions to address pressing challenges, such as:

- (i) Energy transition: Improving understanding of the impact of the energy transition on extractive industries;
- (ii) Corruption risks: Addressing corruption risks and promoting transparency;
- (iii) Gender equity: Promoting gender equity and inclusion in extractive industries; and
- (iv) Revenue collection: Strengthening revenue collection and management.

30.10 Chapter review

This chapter discusses the integration of environmental, social, and governance (ESG) principles within the extractive industry, which includes mining, oil, and gas sectors. It emphasises the growing importance of ESG as a framework for responsible resource development, risk management, and long-term sustainability. The chapter explains that ESG is not merely a compliance tool but a strategic imperative that shapes corporate reputation, investor confidence, and community relations.

30.11 Worked examples

30.11.1 Questions

1. Environmental, social and governance (ESG) is a concept that is increasingly important in business world due to growing concerns about sustainability and good governance.

Required:

Discuss the salient points relating to the three different aspects of ESG, its challenges and opportunities.

2. The need for environmental, social and governance (ESG) evolved overtime. The reality of its importance can no longer be overemphasised. It is a world-wide concept such that the governments of developing nations have to incorporate it as an important policy matter.

Required:

Discuss the following in relation to ESG:

- (a) Regulatory authorities
- (b) The need for ESG

3. Despite the lofty ideas and high expectations of having ESG in place, it faces some basic challenges.

Required:

Discuss the benefits associated with having effective ESG in place.

4. It is a common practice to have disobedient persons – corporate or individual – irrespective of the advantages and merits of any particular programme or idea. Also, it is customary to have disciplinary measures in place for disobedience to constituted authority, rules and regulations.

Required:

Discuss the possible penalties and other costs for non-compliance with government directives on ESG.

30.10.2 Suggested solutions to questions

1. The salient points relating to the three different aspects of ESG, its challenges and opportunities

(a) Environmental compliance

Environmental impact assessments: Companies must conduct EIAs to identify potential environmental risks and develop mitigation strategies.

Waste management: Proper disposal of waste, including hazardous materials, is essential to prevent environmental pollution.

Oil spill response: Companies must have plans in place to respond to oil spills and mitigate their impact on the environment.

Biodiversity conservation: Companies must take steps to protect and conserve biodiversity in areas where they operate.

(b) Social compliance

Community engagement: Companies must engage with local communities, respect their rights, and address their concerns.

Human rights: Companies must respect human rights, including the rights of indigenous peoples and vulnerable groups.

Livelihood restoration: Companies must restore livelihoods affected by their operations, providing fair compensation and support.

Social investment: Companies are expected to invest in social projects that benefit local communities, such as education, healthcare, and infrastructure development.

Cultural heritage Protection: Companies must take steps to protect and preserve cultural heritage sites and artefacts.

(c) Governance compliance

Transparency and accountability: Companies must be transparent in their operations, financial reporting, and decision-making processes.

Corruption prevention: Companies must have anti-corruption policies and procedures in place to prevent bribery and other forms of corruption.

Regulatory compliance: Companies must comply with relevant laws, regulations, and industry standards.

Stakeholder engagement: Companies must engage with stakeholders, including government agencies, civil society organisations, and local communities

Board oversight: Companies must have effective board oversight to ensure ESG compliance and responsible business practices.

(d) Challenges and opportunities

Challenges: Corruption, lack of transparency, and inadequate regulatory enforcement hinder ESG compliance in Nigeria's extractive industry.

Opportunities: Implementing ESG best practices can enhance the industry's reputation, improve relationships with stakeholders, and contribute to sustainable development.

2 (a) Regulatory authorities in relation to ESG

- i. National Environmental Standards and Regulations Enforcement Agency (NESREA): Responsible for enforcing environmental regulations;
- ii. Department of Petroleum Resources (DPR): Regulates the oil and gas industry;
- iii. Nigerian Extractive Industries Transparency Initiative (NEITI): Promotes transparency and accountability in the extractive industry.

(b) Need for ESG

- i. Risk management: ESG considerations can help businesses identify and manage risks related to environmental, social, and governance issues.
- ii. Long-term sustainability: ESG practices can contribute to long-term sustainability and resilience; ensuring businesses remain viable and successful over time.
- iii. Stakeholder expectations: Investors, customers, employees, and communities increasingly expect businesses to prioritise ESG considerations and demonstrate responsible practices.
- iv. Regulatory requirements: Governments and regulatory bodies are implementing ESG-related laws and regulations, making compliance essential for businesses.
- v. Reputation and brand value: Strong ESG practices can enhance a company's reputation and brand value, while poor practices can lead to reputational damage and financial losses.

3. The major challenges facing successful implementation of ESG in Nigeria are: Corruption, lack of transparency, and inadequate regulatory enforcement. These hinder ESG compliance in Nigeria's extractive industry.

Benefits of ESG compliance

- a. Improved reputation: ESG compliance can enhance a company's reputation and build trust with stakeholders.
- b. Increased investment: Companies that demonstrate strong ESG practices may attract more investment and funding.
- c. Reduced risk: ESG compliance can help companies manage risks and avoid costly fines and penalties.
- d. Sustainable development: ESG compliance can contribute to sustainable development and improve the well-being of local communities.
- e. By prioritising ESG compliance, companies in Nigeria's extractive industry can reduce their environmental footprint, promote social responsibility, and ensure good governance.

- f. Improved financial performance: Studies have shown that companies with strong ESG practices tend to perform better financially in the long term.
- g. Increases companies goodwill: ESG practices can build trust and credibility with stakeholders, enhancing a company's reputation and brand value.
- h. By prioritising ESG considerations, businesses can ensure long-term sustainability, build trust with stakeholders, and contribute to a more equitable and environmentally conscious world.

4. Penalties and other possible costs for non-compliance with government directives on environmental, social, and governance (ESG)

a. Financial penalties

- i. Monetary fines: These can vary based on company size and type.
- ii. SEC fines: In the developed countries, non-compliance with ESG disclosures is a serious crime. In the USA for instance, the Securities and Exchange Commission (SEC) has imposed significant fines for ESG-related non-compliance.
- iii. In Nigeria, the Climate Change Act 2021 establishes a legal framework to address climate change, including achieving net-zero emissions by 2050-2070. The Act also introduces a carbon tax. It imposes obligations on businesses to provide for reduction in carbon emissions and also designate an environmental sustainability officer. Failure to comply can result in fines. Also, non-compliance with data protection regulations while processing ESG data can lead to fines and penalties.

b. Legal consequences

- i. Litigation risks: Non-compliance can lead to costly legal battles and potential settlements.
- ii. Regulatory scrutiny: Companies may face stringent audits and investigations, potentially resulting in operational disruptions.
- iii. Loss of operating licenses: In severe cases, non-compliance can lead to loss of operating licenses or restrictions on business operations

c. Reputational damage

- i. Loss of trust: stakeholders, including investors and customers, may lose trust in companies that fail to comply with ESG regulations, leading to reputational damage.
- ii. Negative publicity: Non-compliance can result in negative media coverage, further damaging a company's reputation.

- iii. Competitive disadvantage: Companies that prioritise ESG compliance may gain a competitive edge over non-compliant businesses

d. Operational challenges

- i. Inefficiencies: Non-compliance can lead to operational inefficiencies and reduced innovation.
- ii. Supply chain disruptions: Companies may face supply chain disruptions if their partners or suppliers are not ESG-compliant.
- iii. Future business Opportunities: Non-compliance can limit future business opportunities, as many government bodies and large corporations require ESG compliance from their partners.

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