BANWO & IGHODALO

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FINANCE BILL 2019: TAX IMPLICATIONS FOR NIGERIAN ENTITIES

Introduction

On Thursday, November 21, 2019, the *Finance Bill 2019* (the "**Bill**") was passed by the Senate after scaling through third reading on the floor of the Senate. The Bill had earlier, on October 14, 2019, been submitted to a joint session of the National Assembly (that is, the Senate and House of Representatives of the Federal Republic of Nigeria) alongside the *2020 Appropriation Bill* (the "**2020 Budget**") by His Excellency, President Muhammadu Buhari.

The Bill proposes fiscal measures in support of the 2020 Budget of the Federal Government of Nigeria (the "**FGN**"), with extensive tax implications for the country. With a total proposed expenditure of ₦10.33 trillion against total expected revenue of ₦8.15 trillion, resulting in a deficit of ₦2.18 trillion; the 2020 Budget is projected to be financed partly by tax revenues expected to be generated through the key fiscal changes introduced by the Bill.

This article provides a summary of the reforms proposed in the Bill and highlights their likely impacts on Nigerian entities.

Proposed Key Reforms in the Bill

In the President's letter of October 14, 2019 forwarding the Bill for legislative consideration, the following are listed as the five (5) key strategic objectives of the Bill:

(i) Promoting fiscal equity by mitigating instances of regressive taxation;
(ii) Reforming domestic tax laws to align with global best practices;

(iii) Introducing tax incentives for investments in infrastructure and capital markets;
(iv) Supporting small businesses in line with the FGN's ongoing Ease of Doing Business Reforms; and
(v) Raising required revenue for government, by various fiscal measures, including a proposed increase in the rate of Value Added Tax ("**VAT**") from 5% to 7.5%.

The Bill, amongst other things, generally amends certain key provisions of various tax legislation in Nigeria, with a view to making them more responsive to the tax reform policies of the FGN, and thereby enhance their implementation and effectiveness. The key reforms proposed by the Bill include:

- **Petroleum Profits Tax** – The Bill repeals section 60 of the Petroleum Profits Tax Act and effectively introduces Withholding Tax ("**WHT**") of 10% on dividends paid out of the profits of companies engaged in petroleum operations in Nigeria. By this measure, the Bill seeks to remove the tax exemption granted under the PPTA in respect of such income or dividends.

- **Capital Gains Tax** – The Bill amends sections 32[1] and 36 of the Capital Gains Tax Act. In effect, this seeks to review the exemption from capital gains tax granted to business entities, in the transfer of assets between related parties in a business restructuring exercise. This also seeks to impose capital gains tax on payments of loss of employment compensations exceeding Ten Million Naira (₦10,000,000).

- **Stamp Duties** – The Bill amends sections 2 and 89 of the Stamp Duties Act. In effect, this seeks to extend the scope of stamp duties in Nigeria to cover electronic documents and impose a one-off stamp duty of ₦50 on bank transfers of the sum of Ten Thousand Naira (₦10,000) and above. However, this is proposed to exclude transfers between banking accounts of the same owner, provided that the banking accounts are maintained in the same bank. The Bill also excludes share transfers and payments made in a Regulated Securities Lending ("**RSL**") transaction from the payment of stamp duty.

- **Customs & Excise Tariff** – The Bill amends section 21 (Fifth Schedule) of the Customs, Excise Tariff, Etc. (Consolidation) Act 1995 to include "goods imported" into Nigeria in the list of goods liable to excise duty.

- **Value Added Tax** – The Bill amends sections 2, 4, 10, 15, 46,

[1]Following amendment and renumbering of the CGT Act, merger schemes of which the consideration is shares are now exempted from CGT under section 32.

and the First Schedule of the VAT Act, and proposes the following:

i. Services will be deemed to have been provided in Nigeria and therefore subject to VAT where the recipient is in Nigeria, regardless of whether the services were rendered within or outside Nigeria. However, where the recipient of a service is outside Nigeria, such service shall be deemed *"exported service"* and hence not chargeable to VAT.

ii. On the other hand, the Bill further clarifies that services rendered to the fixed base or permanent establishments of non-resident persons do not qualify as exported service and are therefore subject to VAT. The proposed definition of *"exported service"* in the Bill suggests that the service provided must **flow directly** from the Nigerian resident **to** the person resident outside Nigeria. This means that exported service, as contemplated by the Bill, does not include a transaction where the service in question flows from a Nigerian resident to another Nigerian resident third party **on behalf of** or **for the benefit of** non-resident persons in Nigeria. This is consistent with the recent decision of the Tax Appeal Tribunal, Lagos Zone, in ***Allan Gray Investment Management Limited v Federal Inland Revenue Service*** *(unreported judgment of the TAT delivered on Wednesday, November 13, 2019 in Appeal No. TAT/LZ/VAT/019/2018),* which held that (i) services which flow from service providers in Nigeria to third parties (such as persons resident in Nigeria) **on behalf of** or **for the benefit of** persons resident outside Nigeria do not constitute exported service for tax purposes in Nigeria, and (ii) a Nigerian resident through whom a non-resident person carries on economic activity in Nigeria for profit-making purposes, is effectively an agent of the non-resident person in Nigeria for tax purposes; and, accordingly, liable to satisfy the tax obligations of that non-resident person in Nigeria;

iii. Increase in the VAT rate from 5% to 7.5%;

iv. Introduction of the *Reverse Charge Principle*, which charges the VAT due on imported supplies in Nigeria in the hands of the recipients of such taxable supplies;

v. Removal of the requirement for foreign entities carrying on business in Nigeria to register for VAT in Nigeria and include VAT charges in their invoices;

vi. Exemption of companies with annual turnover of less than Twenty-Five Million Naira (₦25,000,000) from the requirement of filing VAT returns;

vii. Specific description of what constitutes basic food items, within the meaning of the VAT Act, for VAT exemption purposes;

viii. the definition of goods and services has been expanded to cover intangible items that a

person has ownership interest in, or derives benefit from, and which can be transferred to another person, other than land;

ix. Exemption of locally manufactured sanitary pads, tampons, and towels from VAT; and

x. Exemption of nursery, primary, secondary, and tertiary education tuition levies from VAT.

- **Personal Income Tax** – The Bill amends sections 33, 49, and 58 of the Personal Income Tax Act. Hence, individuals are required to produce their Tax Identification Numbers ("**TINs**") before they can operate new or existing banking accounts in Nigeria. The Bill also recognizes electronic mails and courier services as valid means of transmitting objections against tax assessments, to the relevant tax authorities. The Bill also seeks to delete personal income tax reliefs, currently being enjoyed by individuals in respect of their children and dependent adults.

- **Companies Income Tax** – The Bill amends sections 9, 10, 13, 16, 19, 20, 23, 24, 27, 29, 31, 33, 39, 40, 41, 43, 53, 55, 77, 78, 80, 81, 105, and the Third and Seventh Schedules of the Companies Income Tax Act ("**CITA**") to –

i. Exempt from Excess Dividend Tax ("**EDT**") (a) dividends paid out of exempted profits or retained earnings previously subjected to tax, (b) distributions made by real estate investment companies to their shareholders and dividend incomes received on behalf of those shareholders, and (c) franked investment incomes;

ii. Subject the digital economy to tax in Nigeria, including prevention of artificial avoidance of tax by foreign entities which have significant economic presence in Nigeria without maintaining any identifiable physical presence in the country (the Minister of Finance is empowered under the Bill to determine significant economic presence of foreign companies in Nigeria);

iii. Amend the existing commencement and cessation of business rules in order to eliminate incidences of double taxation;

iv. Require companies to produce their TINs before they can operate new or existing banking accounts in Nigeria;

v. Exempt companies with turnover of less than Twenty-Five Million Naira (₦25,000,000) from payment of minimum tax, delete the current basis for computation of minimum tax, introduce minimum tax of 0.5% on the turnover of companies that are subject to minimum tax in Nigeria, and remove the exemption from minimum tax currently enjoyed by companies with minimum twenty-five percent (25%) imported equity capital;

vi. Create a more favourable tax regime for insurance companies in Nigeria by allowing the companies

to carry their losses forward indefinitely. The Bill seeks to achieve this by deleting the existing four-year limitation on carry forward of losses by insurance companies in Nigeria. Other provisions in the Bill impacting insurance companies include: (a) Restriction on deductions allowed for insurance companies on unexpired risks and other deductible gains and outgoings, and (b) requirement for insurance companies to have no less than twenty percent (20%) of their gross incomes as their total profits for tax purposes in any relevant accounting year;

vii. Prevent base erosion and profit shifting by restricting (a) deductible dividends and mandatory contributions made by real estate investment companies to their shareholders, to those duly approved by the Securities and Exchange Commission, and (b) deductible compensating payments made by lenders to those that qualify as interest and are paid to their approved agents in RSL transactions;

viii. Reduce tax planning and management arbitrage practices by disallowing the following expenses for tax deduction purposes: (a) compensating payments which qualify as dividends, made by borrowers to their approved agents or lenders in regulated securities exchange transactions, (b) federal statutory penalties and taxes or penalties paid by a company on behalf of another, (c) expenses involving connected entities except such expenses comply with the Income Tax (Transfer Pricing) Regulations, (d) compensating payments which qualify as dividends, made by approved agents to borrowers or lenders in regulated securities exchange transactions, and (e) expenses incurred in deriving tax-exempt income and any expense that constitutes an allowable deduction under the Capital Gains Tax Act;

ix. Reduce tax burdens for small and medium companies by (a) exempting from tax, dividends and rental income received by real estate companies provided that a minimum of seventy-five percent (75%) of such dividends or rental incomes are distributed within twelve (12) months of the accounting year in which they were earned, and (b) introducing a lower company income tax rate of twenty-percent (20%) on the income of medium-sized companies with annual turnover of between Twenty Five Million Naira and One Hundred Million Naira (₦25,000,000 – ₦100,000,000), and (c) exempting small companies with annual turnover of less than ₦25,000,000 from company income tax.

x. Reduce tax exemption granted in respect of interest on foreign loans, by removing the existing one hundred percent (100%) tax exemption on such incomes; and

xi. Introduce thin capitalization rules on loans issued to Nigerian companies by offshore related entities, by (a) restricting deductions of excess interest expenses which are not fully utilized to minimum periods of 5 years from the year in which the excess interest expenditure was first computed, and (b) limiting deductible interests paid by Nigerian companies to offshore connected entities to thirty percent (30%) of Earnings Before Interest, Tax, Depreciation, and Amortization (EBITDA).

Commentary

As evident from the highlights above, the primary objective of the Bill is the generation of additional revenues for the Government to potentially partly finance the deficit in the 2020 Budget of the FGN. Generally, the Bill seeks to promote fiscal equity by mitigating instances of regressive taxation, reform domestic tax legislation in line with global best practices, and introduce tax incentives particularly for investments in infrastructure and thereby engender, to an extent, the legislative framework necessary for the development and growth of micro, small, and medium enterprises (in support of the FGN's ongoing ease of doing business reforms). By the same token, the Bill imposes higher rates for certain existing taxes and subjects some previously exempted incomes to tax.

One of the key reforms introduced by the Bill relates to EDT risks to which Nigerian entities are currently exposed. By the provisions of section 19 of the CITA, any dividend declared and paid by a company in excess of the total taxable profit declared in any accounting year (**"excess dividend"**) is subject to EDT, regardless of the source or nature of the dividend paid. By virtue of these provisions, most companies who paid out excess dividend out of income earned from investments exempted from tax by declarations contained in Executive Orders or Administrative Instruments, have been unable to enjoy such exemption as recent judicial pronouncements have declared such Orders or Instruments void in the light of the provisions of section 19 of the CITA.[2] The proposed amendment in the Bill regarding EDT is thus a welcome development and we note that it is in line with our recommendation on the issue, in an earlier publication.

In like manner, the proposed amendments to sections 78 and 80 of the CITA are

[2] See **United Capital Assets Management Limited v FIRS** (Unreported judgment of the Tax Appeal Tribunal, Lagos Zone, delivered on September 24, 2019 in Consolidated Appeal Nos. TAT/LZ/CIT/006/2018 and TAT/LZ/CIT/007/2018)

expected to encourage investments in both debt and equity transactions in the capital-market with a focus on regulated securities lending transactions and dividend distribution to a real estate investment company. It is interesting to note that the Bill is silent on the existing withholding tax exemption on corporate and State Government bonds mindful that the exemption will expire in January 2022.

Another significant reform seen in the proposed amendment in the Bill, legalizing service by aggrieved taxpayers on relevant tax authorities, of objections against tax assessments through electronic means, is in conformity with emerging trends and embraces contemporary technological innovations. This proposed amendment is in line with a recent decision of the Tax Appeal Tribunal[3], declaring such electronic means of service as valid and legally binding.

Furthermore, the proposal for taxation of the digital economy and introduction of the reverse charge principle into the Nigerian tax system, readily call to mind the recent decision of the Court of Appeal[4] where it was established that: (a) Whilst the reverse charge principle of international tax is not expressly mentioned in the VAT Act, the philosophy attending the principle is envisaged in the VAT Act and therefore applicable in Nigeria, and (b) the supply of satellite network bandwidth capacities qualifies as *"imported service"* subject to VAT in Nigeria.

However, we note the widespread concern that the introduction of 10% WHT on dividends paid out of the profits of companies engaged in petroleum operations may be excessive; since such incomes would have already been subjected to 85% petroleum profits tax prior to payment of the dividends. Also, the proposed VAT hike from 5% to 7.5% may likely drive up the prices of consumables as the additional tax will surely be passed by suppliers of goods and services to the final consumers or end users. An increase in VAT rate may also result in a corresponding rise in the cost of inputs used in the production of goods and services generally, where such inputs are not specifically included in the exemption list specified in the First Schedule to the VAT Act.

We also note that in order to maximally achieve the planned boosting of investment in infrastructure and the capital market (one of the stated objectives of the Bill), section 102 of the Stamp Duties Act should be amended to exempt from *ad valorem* stamp duties rate, trust deeds issued in respect of bonds transactions. Currently, the applicable stamp duties on this set of capital market transactions raise costs for bond issuers and make compliance with the SEC Rule on limitation on total cost of offer difficult, if not impossible, for the issuers.

[3] See **Earth Moving International Ltd. v FIRS** (Unreported judgment of the Tax Appeal Tribunal, Lagos Zone, delivered on September 17, 2019 in Appeal No. TAT/C2/CIT/030/2018)

[4] See **Vodacom v FIRS** (Unreported judgment of the Court of Appeal, Lagos Division, delivered on June 24, 2019 in Appeal No. CA/L/556/2018)

It remains to be seen if the House of Representatives would concur with the Senate and pass the Bill in its current form or whether further legislative actions would be considered to address some of the concerns that have been raised by Nigerian businesses and entities.

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo.

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