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TAT affirms the applicability of excess dividend tax on dividend paid from tax-exempt incomes

KPMG in Nigeria

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The Tax Appeal Tribunal (TAT or "the Tribunal") recently delivered judgement in the case between Ecobank Nigeria Limited ("Ecobank" or "the Company") and the Federal Inland Revenue Service ("FIRS"). The judgement was to the effect that Section 19 of the Companies Income Tax Act (CITA) on taxation of dividends, otherwise known as the Excess Dividend Tax (EDT), is applicable to income derived from bonds, treasury bills and other short-term government securities which are tax-exempt by virtue of the Companies Income Tax (Exemption of Bonds and Short-Term Government Securities) Order, 2011 ("Exemption Order").

Facts of the case

Ecobank invests in the Federal Government's bonds, treasury bills and other short-term securities alongside its core banking services. The Company reported a tax loss in 2015 financial year after excluding its tax-exempt income from its companies income tax (CIT) computations. However, the Company declared and paid a total dividend of ₦5,545,000,000.00 in that year as detailed below:

- ₦4,372,244,556.00 being income earned from tax-exempt income (i.e., investment in government securities such as treasury bills, bonds etc.); and
- ₦1,172,753,444.00 being income earned from taxable sources (i.e., core banking activities).

In 2016, the FIRS conducted a tax audit exercise on the Company's records and subjected the entire dividend to EDT. The Company contended the FIRS' position on the portion of its dividend that was sourced from tax-exempt income, based on the Exemption Order. However, the Company accepted the EDT liability associated with the income from other sources.

The Company posited that Section 19 should not be applied strictly, in isolation from similar statutory provisions such as Section 23 of CITA, which birthed the Exemption Order. The Company also argued that while the EDT provision served as an anti-tax avoidance rule, in applying the mischief rule of legal interpretation, the combined reading of Sections 19, 23(2) and 84 of CITA was certainly to exclude the application of EDT to income that is expressly exempt from CIT. Otherwise, this will amount to approbation and reprobation by the law at the same time, which is inequitable.

The FIRS rejected Ecobank's arguments and held that the source of the dividend was not relevant for the application of Section 19. Consequently, Ecobank challenged the FIRS' position at the TAT.

TAT's decision

- The TAT relied on its previous decisions in the consolidated case of "*United Capital Asset Management Limited and United Capital Trustee Limited against the FIRS*", "*UAC of Nigeria Plc v FIRS*" and "*Actis Africa Nigeria Limited v FIRS*", where it established that Section 19 of CITA does not concern itself with the source or origin of the dividend declared.
- Specifically, the TAT held that notwithstanding the fact that interest and gain earned from investments in bonds, treasury bills and other short-term government securities are tax-exempt, companies that invest in such tax-exempt activities are still liable to EDT on their profits where the conditions stipulated in Section 19 are met. The EDT liability will arise where a company has no total profits, or the dividend is more than the total profit for the year.

The TAT invoked the mischief rule to interpret that the defect which Section 19 was intended to cure was to generally subject companies that made losses, but declared huge dividends, to CIT. Thus, Ecobank's case fell into this situation.

Comments

- The Tribunal in the Ecobank case was right to move past the literal application of Section 19 of CITA to income that is expressly exempted from CIT on account of the absurdity likely to be created. However, its attempt to resort to the mischief rule of interpretation of statutes did not go far enough to enable it to reach a positive view of the situation, thereby saving Section 19 from the need for legislative amendment.
- The TAT's effort to properly interpret Section 19 of CITA may have inadvertently elevated EDT as a separate form of tax and not merely an alternative means of calculating CIT. Section 23(2) of the CITA clearly

exempts income from bonds and similar instruments from tax, and Section 105 of CITA defines "tax" to mean the tax imposed by the CITA, which includes EDT. It stands to reason, therefore, that EDT should not apply to income from bonds and similar instruments by virtue of the Exemption Order.

- The TAT's interpretation of Section 19 of CITA, if allowed to stand, will potentially create a conflict with government policy of encouraging participation by the private sector in bonds, short and long-term government securities. This is because any benefit accruing to investors from such tax exemption will be eroded by subjecting the income to CIT on EDT basis.
- The TAT decision did little to encourage the administration of tax/justice to adopt an interpretation that is wholesome and consistent with the directionality of public policy, thereby making legislative action inevitable. In this circumstance, the Federal Government of Nigeria, particularly the National Assembly and the Executive, must be commended for the modifications that have now been made to Section 19 of CITA by the Finance Act, 2019, which was signed into law by President Muhammadu Buhari, GCFR, on 13 January 2020. The Finance Act has now amended Section 19 of CITA to make clear that income that is exempted from CIT will not fall under the purview of the anti-avoidance provision thereof.
- We can only hope that, in due course, the judiciary will have an opportunity to reflect on the old provisions of Section 19 of CITA and adopt a purposive interpretation that avoids the contradiction of exempting income from CIT on one hand, whilst bringing the same income into the tax net under Section 19 of CITA. Where there is such ambiguity in applying tax laws, the time-old approach has always been to adopt the *contra fiscum rule,* that is, an interpretation that is most favourable to taxpayers.

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