



# Finance Act, 2019

## Impact Analysis

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## Preface

On 13 January 2020, His Excellency, President Muhammadu Buhari, GCFR, signed the Finance Bill, 2019 into law to become the Finance Act, 2019. Following the President's assent, the Honorable Minister for Finance, Budget and National Planning announced 1 February 2020 as the effective date for implementing the Value Added Tax rate increase from 5% to 7.5%. The Federal Inland Revenue Service is expected to issue a clarifying circular in due course.

The Finance Bill was an Executive Bill prepared by the Honourable Minister for Finance, Budget and National Planning, which was approved by His Excellency, the President, Muhammadu Buhari and presented together with the 2020 Budget proposals on 14 October 2019 to a joint sitting of the National Assembly. The Bill was subsequently reviewed by the National Assembly, passed by the Senate on Wednesday, 20 November 2019 and the House of Representatives on Wednesday, 27 November 2019, respectively, prior to assent by the President to culminate into the Finance Act, 2019 (hereinafter referred to as "the Finance Act").

The passage of the Finance Act is a significant milestone for Nigeria as it marks a return to an era of active fiscal supervision motivating regular review of the macro environment and stimulation of the economy on an annual or at least regular basis by means of such instruments as a Finance Act. It is instructive that the Finance (Miscellaneous Provisions) Act No.30 of 1999 represents the last time Nigeria utilised this budgetary fiscal tool in moderating the tax environment for business.

The Finance Act introduces changes to the Companies Income Tax Act, Value Added Tax Act, Petroleum Profits Tax Act, Personal Income Tax Act, Capital Gains Tax Act, Customs and Excise Tariff Etc. (Consolidation) Act and Stamp Duties Act. Having now been passed by both arms of the National Assembly, and thereafter assented to by the President, it is expected that its provisions will come into force in 2020 calendar year together with the Budget and the Appropriation Act that was signed by the President in December 2019.

The amendments made by the Finance Act are intended to raise necessary revenue required to defray public expenditure, support sustainable increase in public revenue and ensure that tax law provisions are consistent with the national tax policy objectives of the Federal Government of Nigeria. The amendments are staged across five broad thematic areas to:

- a) promote fiscal equity by mitigating instances of regressive taxation;
- b) reform domestic tax law to align with global best practice;
- c) introduce tax incentives for investment in infrastructure and capital markets;
- d) support small businesses in line with the ease of doing business reforms and;
- e) raise revenue for government, by various fiscal measures, including, for instance, increase in the VAT rate from 5% to 7.5%.

This publication contains an analysis of the amendments contained in the Finance Act and the expected impact of these changes on tax administration, revenue generation and businesses operating in various sectors of the economy.

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# 1 General Implications of the Finance Act on the Nigerian economy

## 1.1 Tax Revenue Gap

Nigeria's domestic revenue mobilization has been one of the lowest in the world. This has had a severely limiting impact on economic growth and creation of an enabling framework for investments.

According to the Organisation for Economic Co-operation and Development (OECD)'s Revenue Statistics in Africa 2019 report, Nigeria's tax-to-Gross Domestic Product (GDP) in 2017 was 5.7%. This was a moderate increase from the figures reported in 2016 (5.3%). However, when compared with the same index across other African countries over the same period, it was apparent that Nigeria's tax revenue generation was significantly low for the level of economic activities in the country. Specifically, the 26 African countries (including Ghana and Botswana) reviewed in the OECD's study reported an average tax to GDP ratio of 17.2% (11.5 basis points higher than Nigeria's ratio)<sup>1</sup>.

The Federal Government implemented tax amnesty initiatives between 2016 and 2018 to drive up tax revenue and expand the tax base. However, these initiatives have proven insufficient to stimulate the type of revenue growth required. As at 2018, the nation's tax to GDP ratio was estimated at roughly 6%, a slow and unimpressive growth from 2016.

Recent data from the National Bureau of Statistics indicates that Nigeria's GDP was ₦31.79 trillion in the first quarter of 2019 (Q1 2019), while the total government collection in taxes was barely ₦1.5 trillion in that quarter. This produced a tax to GDP

estimate of about 4.7%, which was a decline from prior periods.

Oil production disruptions and price shocks have accounted largely for the unimpressive tax revenue return as the nation has largely depended on revenue from oil sources. Oil revenue remitted to the Federation Account has been lower than its potential level due to the cost of petrol price subsidy and insufficient contributions from Nigerian National Petroleum Corporation. Other factors, such as legislative uncertainty, have also impacted investment in the sector. Non-oil revenues have been stagnant at less than 4% of GDP, offering no buffer against oil revenue volatility.

## 1.2 How the Finance Act seeks to address tax revenue gap

Some of the factors highlighted as contributing to the poor tax to GDP ratio are a sub-optimal Value Added Tax (VAT) system (which deviates from modern consumption tax designs), comprising a low standard VAT rate of 5% and restricted recoverability of input VAT. Other factors, such as extensive use of tax incentives to encourage investment, have resulted in a narrowing of the corporate tax base. A weak tax administration system coupled with high cost of taxpayer compliance has also resulted in a systemic non-compliance and a lack of faith in the tax system. These challenges are typical of a number of tax jurisdictions, however, the lack of responsiveness of the Nigerian tax system in a dynamic and ever changing economic and business environment further exacerbate these issues.

It is imperative that the Nigerian tax legislation is updated frequently to respond to the challenges of today's business environment which therefore underscores the

importance of the Finance Act 2019. The Finance Act is the first of its kind in over two decades and is intended to support the funding of the 2020 budget. The Finance Act contains several long-awaited changes to the tax framework which seek to address issues of low tax revenue growth, such as an increase in the VAT rate to 7.5% and the introduction of tighter deductibility rules.

In view of global economic and tax trends, the Finance Act also seeks to modernize the Nigerian tax system by incorporating recommendations of the OECD on taxation of the digital economy and profits earned by non-resident companies. These proposals have been recommended for global adoption in recognition of the impact of globalization and technology, whereby trade flows increasingly transcend traditional and formal frameworks. Nigeria will thus be one of the few early adopters of globally relevant tools for tracking and harnessing tax revenue from economic activities that occur within our fiscal community.

Furthermore, the Finance Act seeks to provide a boost to small and medium scale enterprises by reducing their tax burden. It also seeks to replace existing tax incentives with more targeted incentives to stimulate economic activity in the capital market and infrastructure sectors.

Finally, the Finance Act amends several onerous tax provisions which have impeded investment in Nigeria, such as the complex insurance tax rules and the excess and interim dividend tax rules that limit the dividend available for distribution to shareholders as contained in the Companies Income Tax Act.

Overall, the provisions contained in the Finance Act are intended to incentivize economic activities to stimulate GDP growth and facilitate increase in the revenue generated.

<sup>1</sup>OECD Revenue Statistics in Africa 2019 Nigeria



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## 2 Direct Taxes

The Finance Act 2019 provides amendments to the various pieces of Nigerian income tax legislation across the key thematic areas. These changes are discussed under the relevant tax Acts as follows:

### 2.1 Capital Gains Tax Act (CGTA) Cap C1, Laws of the Federation of Nigeria (LFN) 2007

#### 2.1.1 Restricted tax exemption on compensation for loss of office

The Capital Gains Tax Act (CGTA) imposes tax at 10% on any capital sum received as compensation for loss of office. The Finance Act, however, limits the impact of this provision by exempting any capital sum of N10 million or less received as compensation for loss of office.

#### 2.1.2 Tax concessions on assets transferred pursuant to a related party business reorganisation

The Finance Act introduces tax concessions for business reorganisations to exempt chargeable gains on assets transferred pursuant to a related party business reorganisation from CGT, subject to meeting certain conditions.

We have discussed the details of this change and the impact thereof in *Chapter 7: Impact on Business Reorganisation*.

### 2.2 Companies Income Tax Act (CITA) Cap C4, Laws of the Federation (LFN) 2004 (as amended)

#### 2.2.1 Taxation of non-resident companies

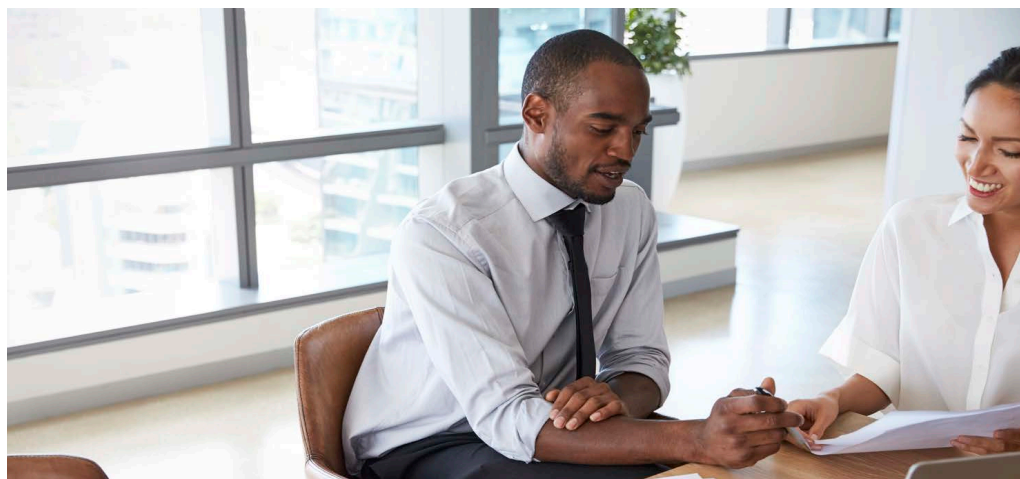
##### (i) Introduction of Digital and Service Permanent Establishment

The Finance Act modifies the provisions of Section 13 of the CITA to create a nexus for the taxation of income earned by foreign companies from technical, management, consultancy or professional services that are remotely provided to a person resident in Nigeria. The tax payable by such foreign companies will be limited to the Withholding Tax (WHT) deducted from them on such payments.

The Finance Act also introduces provisions to tax any foreign company that “transmits, emits or receives signals, sounds, messages, images or data of any kind from cable, radio, electromagnetic systems or any other electronic or wireless apparatus to Nigeria in respect of any activity, including electronic

commerce, application store, high frequency trading, electronic data storage, online adverts, participative network platform, online payments and so on, to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity.” The Finance Act does not define what constitutes “*significant economic presence*,” but empowers the Minister of Finance to define the term. The expectation is that ministerial guidance will be provided now that the Act has been passed.

We have discussed this extensively in *Chapter 8: Impact on the Digital Economy*.



### 2.2.2 Taxation of Dividend

#### (ii) Exemption of profits from Excess Dividend Tax rule

The Excess Dividend Tax (EDT) provision contained in the CITA is intended as an anti-tax avoidance rule that creates a minimum level of protection against corporate tax avoidance using aggressive tax planning schemes. According to the rule, dividends paid by a company in any year should be deemed to be that company's taxable profit for the year, if the actual taxable profits is less than the dividend paid in the same year.

A strict interpretation of this provision has sometimes resulted in further taxation of profits that have already suffered tax, i.e., after-tax profits transferred to retained earnings account. In some other instances, this provision has been applied to dividends paid out of tax-exempt profits, thereby, effectively rescinding the tax-exemption on those profits. The unintended consequences of a strict interpretation of the rule has caused several disputes between taxpayers and the Federal Inland Revenue Service (FIRS), some of which have been adjudicated on by the courts in favor of the FIRS.

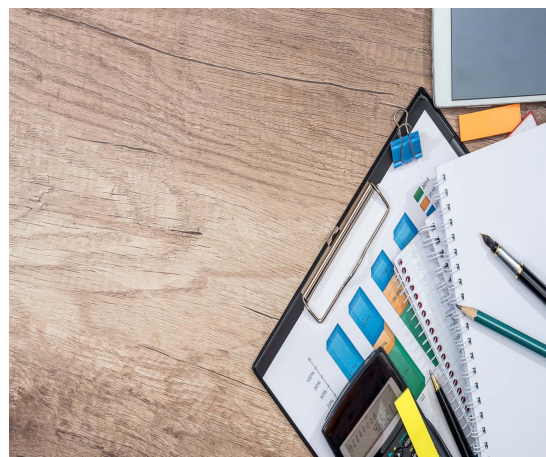
The Finance Act seeks to mitigate the above incidence of (double) taxation by excluding certain profits from the rule. These profits include franked investment income, after-tax profits, tax-exempt income and distributions made by Real Estate Investment Companies etc.

That said, companies are

encouraged to properly track the sources of the dividends they declare (and possibly disclose these sources on their financial statements) in order to enjoy the exemptions. It may also be useful for some companies to update their current dividend policy to ensure alignment between the dividend paid to shareholders and the tax payable to government.

#### (iii) Amendment of the requirement to pay income tax on interim dividend distributions.

Every company liable to tax under the CITA is required to make an advance payment of its CIT prior to paying interim dividends. This requirement is generally regarded by taxpayers as moribund, though it was not deleted from the law, after Nigeria transitioned in 1993 from the provisional-tax-cum-government-assessment era to the self-assessment regime. It was in the same year that the scope of transactions liable to WHT, which was limited at the time to interest, royalty, rent and dividend payment, was significantly expanded to cover payments relating to active business transactions. Consequently, the general view was that the WHT deducted from companies income from business transactions, which is an advance payment of their CIT, made the requirement to pay advance CIT prior to paying interim dividend redundant.



Thus, the FIRS Public Notice of 14 October 2015 on its decision to commence the collection of advance CIT on interim dividend payment came as a surprise to many tax professionals and might have disrupted/ affected companies cash flows since then.

The repeal of this provision as contained in the Finance Act is, therefore, a welcome development to many taxpayers. However, in deleting the provision, the WHT exemption on dividends in specie has also been removed. Taxpayers who would typically pay dividends in the form of scrip issue are therefore encouraged to take note of this significant change.

### 2.2.3 Introduction of new expense deductibility rules

#### (i) Expenses Incurred in respect of exempt income

The underlying principle for the tax-deductibility of expenses in Nigeria is that such expenses must have been wholly, reasonably, exclusively and necessarily incurred for the purpose of the business. The Finance Act does not introduce any fundamental changes to this principle. However, it modifies the way the rules are applied with the intention of closing loopholes in the application of expense deductibility rules.

One such loophole is that a company may deduct expenses incurred to generate tax-exempt income (such as foreign-sourced dividend, interest, rental and royalty income brought into Nigeria through government-approved channels, income on bonds, treasury bills etc.) from non-exempt income. Consequently, the non-exempt income is diminished by an excessive expense deduction and, by extension, the profits available for tax is significantly reduced.

The Finance Act proposes to close this loophole by introducing expense deductibility rules. Accordingly, companies are now permitted to only take a tax deduction for expenses incurred in the generation of non-exempt income. Expenses incurred in the generation of tax-exempt income would no longer be allowed as a tax deduction.

It will become mandatory for companies to properly track and/or apportion the costs relating to their tax-exempt business segments and revenue streams to ensure that such expenses are disallowed for tax purposes.

Taxpayers are therefore advised to formulate a fair and equitable basis for cost apportionment.

#### (ii) Gross-up Clauses

The Finance Act seeks to address the deductibility of taxes borne by a company on behalf of another person. This, for instance, will affect Pay-As-You-Earn taxes borne by some companies on behalf of their employees, transaction taxes borne on behalf of foreign service providers, landlords, etc. Thus, such arrangements may need to be reviewed to manage the increased incidence of corporate tax they will create.

#### (iii) Management Fees and other related party cost

The Finance Act eliminates the bureaucracy associated with obtaining regulatory approvals required to claim management fee-related expenses and expenses incurred outside Nigeria for and on behalf of a company as a tax-deductible expense. Deductibility of these expenses have been the subject of debate, and even adjudication, in recent years.



Thus, the clarity the Finance Act brings, by basing the tax-deductibility of such related-party expenses on their consistency with the Transfer Pricing (TP) Regulations, would in large parts resolve these controversies.

#### (iv) Restriction of deductible interest to 30% of EBITDA

The Finance Act introduces interest deductibility rules

for Nigerian companies and any fixed base of a foreign company in Nigeria. The rules limit the deductibility of interest and similar expenses incurred by a Nigerian company, in respect of debt issued by a foreign connected person, to 30% of the Nigerian company's Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) in the accounting period.

Interest expense in excess of this cap will be disallowed in the current tax year but can be carried forward and treated as tax-deductible for a maximum of five tax years. Violation of the interest deductibility rules will attract penalty and interest charges on any adjustments made by the FIRS on the excess interest deducted in a tax year.

This provision is based on Action 4 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) report. Companies will therefore need to review the interest payable on their related party loan arrangements, on an annual basis, to ensure consistency with the limitation of interest

deduction rule. This rule does not however apply to subsidiaries of foreign companies engaged in the business of banking or insurance.

**2.2.4 Simplification of commencement and cessation rules and elimination of the double taxation risks associated with their application**

The CITA hitherto provided special rules for determining the tax base of a company in the first three years of business and in the last two years of business. These rules, which were referred to as the "Commencement" and "Cessation" rules, respectively, had often resulted in double taxation of profits earned in one or more financial years of the company during these periods.

The Finance Act modifies the commencement and cessation rules such that companies pay taxes based on their accounting periods. The implication of this modification is that companies will now be allowed to prepare and file tax returns in their first, second and third years of assessment

based on their first, second and third sets of financial statements thereby eliminating the double tax risk associated with application of the erstwhile commencement and cessation rules.

**2.2.5 Moderation of Foreign Loan Exemption**

Under the erstwhile provisions of the CITA, foreign companies were allowed to enjoy full (100%) or partial (10%, 40% or 70%) WHT exemption where the terms of a loan provided to a Nigerian person meet the specific grace period and loan tenor requirements under the CITA.

However, the Finance Act modifies this exemption by revising downward the WHT exemption applicable on interest income on foreign loans. The revised exemption rates are now 70%, 40% and 10%.

Furthermore, the Finance Act also attempts to resolve the extensive debate on the conditions for qualifying for the exemption by providing a definition for the terms, "repayment period" and "moratorium period".

The impact of the modification may be significant to several companies who have existing foreign loan facilities structured to enjoy the exemption. Thus, these companies may consider proactively evaluating the potential impact of the above change to their financing model.

**2.2.6 Minimum tax**

The Finance Act replaces the cumbersome procedure for





computing minimum tax, under the CITA, with a simplified base rate of 0.5% of the qualifying company's gross turnover less franked investment income. This modification was made in recognition of the need to shift the impact of minimum tax from capital basis to a purely revenue-based approach.

The more far-reaching amendment of this section is the deletion of the previously available exemption for companies with at least 25% imported equity capital and the addition of a new class of companies exempted from minimum tax, being small companies with an annual gross turnover of less than ₦25 million.

In effect, all non-resident companies and many foreign-owned companies operating in Nigeria, which were hitherto exempted from paying minimum tax, will now fall within the minimum tax net (unless they meet the other criteria for minimum tax exemption). It is expected that this change will create equity between multinational and indigenous companies.

### 2.2.7 Introduction of a progressive CIT system

Prior to the enactment of the Finance Act, the generally applicable CIT rate in Nigeria was 30% of taxable profits. However, manufacturing and agric businesses in their first 5 – 7 years were allowed to pay tax at a reduced rate of 20%. Unfortunately, this incentive did not apply to start-ups, Small Enterprises (SEs) and Medium-sized Companies (MSCs).

In line with the Federal Government of Nigeria's commitment to encourage growth and development of the SEs and MSCs, the Finance Act introduces a new progressive CIT rate regime. Under the revised regime:

- a) Start-ups and SEs with annual gross turnover of not more than ₦25 million would be completely exempted from paying CIT subject to timely filing of CIT returns.
- b) MSCs whose turnover exceeds ₦25 million but is less than ₦100 million will be subject to CIT at 20%.
- c) Every other company with annual gross turnover of ₦100 million and above, which are defined by the Finance as "large companies," will pay tax at the standard CIT rate of 30%.

### 2.2.8 Changes to Modalities for payment of tax

Prior to enactment of the Finance Act, companies were allowed to pay their taxes either in full, within 60 days of the due date of filing their returns, or in a maximum of six-monthly instalments with the final instalment being paid before the 30th day of November in the relevant year of assessment.

However, the Finance Act modifies the applicable payment terms by:

- a) requiring companies filing self-assessment to pay their taxes in full on or before the due date of filing; and
- b) offering a tax credit equal to 1% (2% for medium-sized companies) of the amount of tax paid, where a company pays its taxes 90 days before its due date for filing.

These changes are intended to improve taxpayer compliance, ease tax administration and enforce prompt payment of taxes. It is, however, unclear whether the early tax payment incentive offered is significant enough to stimulate the type of taxpayer behavior envisaged by the government.

### 2.2.9 Other noteworthy changes

- a) Requirement for every company to provide a Tax Identification Number as a precondition for opening or continued operations of an account with a bank or any other financial institution.
- b) Non-deductibility of any penalties prescribed by any Act of the National Assembly for violation of any statute.
- c) Modification to the tax rules for insurance companies. Please refer to *Chapter 5: Financial Services Industry Impact Analysis* for details.
- d) Removal of the seeming restriction on the ability to carry forward first year losses indefinitely.
- e) Introduction of a specialised tax framework for Securities Lending Transactions. Please refer to *Chapter 5: Financial Services Industry Impact Analysis* for details.

- e) Introduction of specialised tax rules for a Real Estate Investment Company. Please refer to *Chapter 4: Consumer Markets and Infrastructure Industry Impact Analysis* for details.
- f) Reduction of the WHT rate on road, bridges, building and power plant construction contracts from 5% to 2.5%. Please refer to *Chapter 4: Consumer Markets and Infrastructure Industry Impact Analysis* for details.
- g) Introduction of minimum holding period rules for related party business reorganisations under Section 29(9) of the CITA. Please refer to *Chapter 7: Impact on Business Reorganisation* for details.
- h) Amendment to the export profit exemption rules. Please refer to *Chapter 4: Consumer Markets and Infrastructure Industry Impact Analysis* for details.
- i) Amendment of the incentives available under the Gas Utilisation (Downstream Sector) Incentive. Please refer to *Chapter 6: Oil and Gas Industry Impact Analysis* for details.

- j) Deletion of redundant provisions relating to replacement of obsolete plant and machinery under Section 41 of the CITA.
- k) Exemption of unit trust dividend from WHT. Please refer to *Chapter 5: Financial Services Industry Impact Analysis* for details.

### 2.3 Petroleum Profits Tax Act (PPTA) Cap C4. Laws of the Federation (LFN) 2004 (as amended)

Under the erstwhile PPTA framework, dividends paid out of after-tax profits were exempted from tax under any other taxing legislation. Consequently, investors in upstream petroleum operations in Nigeria were allowed to enjoy tax free returns on investment.

The amendment revokes this exemption and subjects such investors to WHT, which is the final tax payable by the investors on those profits. Please refer to *Chapter 6: Oil and Gas Industry Impact Analysis* for details.

### 2.4 Personal Income Tax Act (PITA) Cap P8 Laws of the Federation (LFN) 2004 (as amended)

The Finance Act provides the following modifications to the PITA:

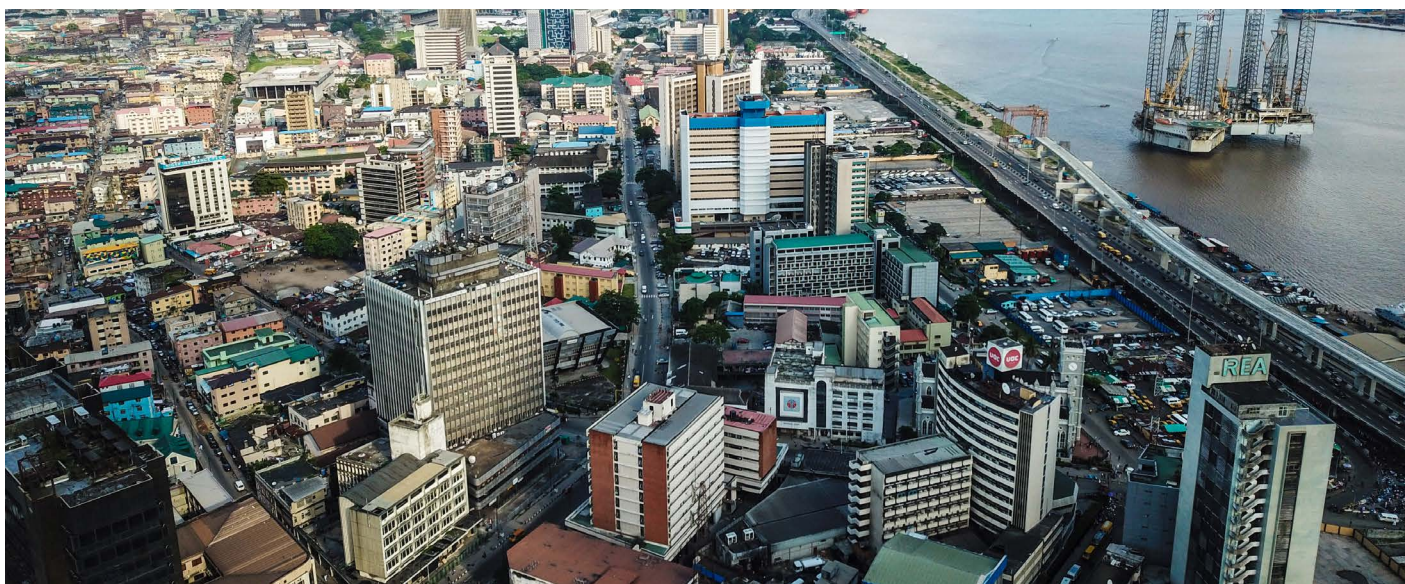
- a. Requirement for every person (body corporate, trustee, partnership, etc.) to provide a Tax Identification Number as a precondition for opening a bank account and for continued operations of its bank account in respect of its business operations.
- b. Replacing reference to Federal Board of Inland Revenue with Federal Inland Revenue Service.
- c. Removal of the requirement to obtain approval from the FIRS as a precondition for claiming contributions made to a pension, provident and other retirement benefits fund as a tax-deductible expense.
- d. Deletion of the provisions granting children and dependent relative allowances and life assurance premium relief. This amendment seeks to resolve the controversies surrounding the entitlement of chargeable persons to children and dependent relative allowances in addition to the consolidated relief allowance granted under the PITA.
- e. Clarification that a notice of objection submitted via electronic e-mail will be considered valid.





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## 3 Indirect taxes



The Finance Act 2019 contains amendments to the legislation on indirect tax across the key thematic areas. These changes are discussed under the relevant Acts as follows:

### 3.1 Value Added Tax Act (VATA), Cap V1, LFN 2007 (as amended)

#### 3.1.1 Increase in VAT rate and palliative measures to manage its impact

A tenet of Nigeria's National Tax Policy is a gradual shift from reliance on direct tax to indirect tax for economic growth. To achieve this, a progressive increase in the VAT rate and a gradual reduction in income tax rate is recommended. According to the National Tax Policy, indirect taxes are more efficiently realised by the FIRS and, therefore, yield a higher rate of return, when compared to direct taxes.

The Finance Act provides for a VAT rate increase by 50%, i.e., from 5% to 7.5%. The rate increase, when combined with other VAT-related changes, is expected to increase VAT revenue significantly.

To mitigate the impact of the revised VAT rate

increase to 7.5% and facilitate economic growth and development through SMEs, the Finance Act introduces palliative measures for micro and small enterprises.

One palliative measure is the introduction of a VAT compliance threshold. The threshold is to exempt companies with an annual turnover of ₦25,000,000 or less from registering for the tax, charging the tax, rendering a monthly return of its sales and purchases and from the penalties prescribed by the Act for non-compliance with the administrative provisions.

It is expected that, by introducing a VAT compliance threshold, the cost of tax administration will reduce because the FIRS can now focus its compliance monitoring efforts on large businesses only. When combined with an increased VAT rate, increased tax yield may be achieved on an overall basis. This measure also encourages many more companies to come voluntarily into the formal tax net for the purpose of

enjoying the tax benefits available. It is hoped that once businesses then come into the tax net, they would stay even after their businesses grow beyond the exemption threshold thus allowing their contribution to the treasury in future years.

Another noteworthy palliative is exemption of services rendered by microfinance banks (unit, state and national) from VAT. This will, hopefully, create a wider opportunity for growth and development of micro, small and medium enterprises.

#### 3.1.2 Broadening the scope of coverage of the Nigerian VAT Act

The erstwhile provisions of the VAT Act did not contain a definition of goods. Consequently, VAT-able goods had, in practice, been limited to tangible goods that are not exempted under the First Schedule to the Act. Incorporeal property was generally accepted as non-VATable, by taxpayers, on the basis that such property neither constitute goods

nor services and supply thereof cannot attract VAT.

In fact, the Federal High Court had ruled in the case between CNOOC Exploration and Production Nigeria Limited and the FIRS that interest in rights in an oil concession is an incorporeal property; it is neither a good nor service, which are the two categories of taxable items under the VAT Act. This judgement further validated the view that transactions in incorporeal property should not attract VAT.

The Finance Act seeks to expand the definition of “goods” to include ‘any intangible product, asset or property over which a person has ownership or rights, or from which he derives benefits, and which can be transferred from one person to another, excluding interest in land’’. Consequently, the VATability of incorporeal property, such as rights, patents, trademarks, royalty, etc., that was hitherto debated has now been legislated in favour of the treasury.

### 3.1.3 Place of supply rules

Another controversial issue that may potentially be resolved by the Finance Act is the VAT-ability (in Nigeria) of services provided outside Nigeria by a non-resident company (NRC) to a Nigerian company. One view on the subject is that such transactions should be liable to VAT in Nigeria because the recipient is in, and consumed the services, in Nigeria – meaning the services were effectively supplied in Nigeria. The contrary view is that a service supplied outside



Nigeria should not be liable to VAT in Nigeria simply because it was enjoyed by a Nigerian-based customer.

The differing views on the subject have been debated extensively by taxpayers and the FIRS, and has even been submitted to the courts, including the Court of Appeal (CoA), for determination. According to the CoA, in the case between Vodacom and the FIRS<sup>2</sup>, such services should be liable to VAT in Nigeria if provided to a Nigerian-based customer and enjoyed in Nigeria. It is noteworthy that this conclusion aligns with the Organisation of Economic Cooperation and Development’s Destination Principle.

The Finance Act seeks to resolve this ambiguity by introducing “place of supply rules” for services. According to the Finance Act, a service would be deemed to be supplied in Nigeria if the “services are rendered in Nigeria by a person physically present in Nigeria at the time of service provision, or the services are provided to a person in Nigeria, regardless of whether the services are rendered

within or outside Nigeria’’. By implication, every service supplied (either locally or imported) to a Nigerian-based customer and enjoyed in Nigeria becomes VATable in Nigeria.

Furthermore, the Finance Act also seeks to resolve the current controversy on the definition of “exported service”, which is zero-rated for VAT purposes by redefining exported service as a “service rendered within or outside Nigeria by a person resident in Nigeria, to a non-resident person outside Nigeria”.

These amendments would align Nigeria’s VAT Act with the global best practice of subjecting a transaction to VAT only in the jurisdiction of consumption, i.e., the Destination Principle.

Certainty around taxation is critical for raising revenue and for business planning purposes. It also gives the FIRS the opportunity to collect revenue that would otherwise be lost simply because of the ambiguity in law and significantly reduce the costs incurred in adjudicating the matter.

<sup>2</sup>Vodacom Business Nigeria Limited vs FIRS; Appeal no. CA/L/556/2018)

### 3.1.4 Cash basis for accounting for VAT and VAT refunds

The Finance Act provides clarification that VAT should be accounted for on cash rather than accrual basis.

Accounting for VAT on cash basis means that a taxpayer can only recover input VAT that has been “paid” against output VAT that has been “collected”. For taxpayers who do not have input VAT to claim, it is only VAT that has been collected that should be remitted to the FIRS. The amendment would help manage taxpayers’ cashflows and reduce the risk that a business ultimately bears the VAT burden for its customers, particularly in cases of bad debt.

A taxpayer who is entitled to a VAT refund is required to first recover its overpayment as a credit against subsequent VAT collections. Any excess over and above the amount credited against VAT collections would then be refunded. By so doing, the current practice of applying VAT overpayments as a credit would be prescribed into law. Furthermore, the administrative cost to businesses for making refund claims should reduce significantly.

Although the Act does not prescribe conditions under which a refund claim may be made, it may be reasonable to conclude that refund claims should only be made after it has been determined that the Company would not collect enough output tax from which recoveries can be made. Such circumstances, in our view, would include dormancy, cessation or companies whose inputs are used in the creation of zero-rated goods, etc.

### 3.1.5 Imposition for all customers to self account for VAT

The Finance Act introduces a requirement for Nigerian customers to self-account for VAT where the supplier of VAT-able goods or services failed to charge VAT.

By implication, customers who transact business with persons below the VAT compliance threshold will now take on the obligation to account for the VAT, that would otherwise have been accounted for by such persons. It remains to be seen whether the ‘self-account’ rule will apply to transactions between two persons who are exempt from VAT compliance.

### 3.1.6 Other noteworthy amendments

- a) Imposition of an obligation on a Nigerian customer to self-account for VAT, regardless of whether the NRC charges the VAT or not.
- b) VAT exemption on assets transferred pursuant to a related-party business reorganisation, subject to satisfying the minimum holding (of shares) period requirement.
- c) More punitive penalties for non-compliance. For example, an increase in the penalty for failure to register for VAT as prescribed from ₦25,000 for the first month in which the default occurs and ₦5,000 in subsequent months of default to ₦50,000 in the first month, and ₦25,000 in subsequent months.
- d) Introduction of a requirement to deregister for VAT in the event of business cessation.
- e) A definition of “basic food items” and an enumeration of food items that qualify as basic food items. For example, a clear articulation that bottled water qualifies as a basic food item.

- f) Widened scope of VAT exempt items to include locally manufactured sanitary towels, pads and tampons, tuition relating to nursery, primary, secondary and tertiary education.
- g) Deletion of redundant provisions in the VAT Act, such as section 32, which is a duplication of the penalty for failure to register stated in Section 8 of the VAT Act.

## 3.2 Customs and Excise Tariff etc. (Consolidated) Act, Cap C49, Laws of the Federation of Nigeria 2004

Prior to enactment of the Finance Act, excise duty (ED) was applicable on excisable goods. However, such goods when imported into Nigeria did not attract ED.

The Finance Act seeks to address this disparity by subjecting imported excisable products to ED.

Please refer to *Chapter 4: Consumer Markets and Infrastructure Industry Impact Analysis* for details.

## 3.3 Stamp Duties Act (SDA) S8, LFN 2007

The Finance Act provides for modifications to the SDA that legalises the charge of stamp duties on electronic receipts and also appoints the FIRS and State Internal Revenue Service as the relevant competent authorities responsible for collecting stamp duty on behalf of the Federal Government and the State Governments, respectively. This addresses the dispute between the NIPOST and the FIRS as to which body is responsible for collecting the duties.

## 4 Consumer Markets and Infrastructure Industry Impact Analysis



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### 4.1 Consumer Markets

The Consumer and Industrial Markets (CIM) industry comprises the manufacturing and trade sectors of the Nigerian economy, and accounts for about 23.97% of the country's real GDP<sup>3</sup>. While this is significant, it is a far cry from the full potential of the industry, considering Nigeria's large and youthful population and growing middle class. Unfortunately, the sector's growth has been stifled over the years by the huge infrastructural gap in the country, particularly in relation to power and transportation. These factors, combined with the tough macroeconomic environment, low access to credit, uncertainty in government policies, dependence on foreign inputs, etc., have limited the CIM industry's ability to enable the realization of the Federal Government's economic diversification agenda.

The Federal Government has made some efforts to address the above challenges in recent years. For instance, it introduced the Road Infrastructure Development and Refurbishment Investment Tax Credit Scheme in January 2019, in a bid to address road infrastructure deficit in key economic areas of Nigeria. Also, the recent directive of the Central Bank of Nigeria to Deposit Money Banks to increase their Loan-Deposit Ratio to 65%, with special consideration

for operators in retail and consumer markets, is expected to increase lending to players in the CIM industry and possibly, reduce lending rates.

The Finance Act contains additional fiscal measures by which the Federal Government seeks to stimulate the CIM industry, some of which we have highlighted below:

#### 4.1.1 Change to the condition for the tax-exemption of export profits

The CITA exempts the profits derived by a Nigerian company from goods exported out of Nigeria, "provided that the proceeds of such exports are repatriated to Nigeria and are used exclusively for the purchase of raw materials, plant, equipment and spare parts".

In practice, the requirement for repatriation imposes an unnecessary administrative burden on exporters.

The Finance Act intends to address this by simply requiring affected companies to demonstrate that the proceeds were used to procure raw materials, plant, equipment and spare parts, thereby eliminating the need to first repatriate the

proceeds and the requirement to use the proceeds only for inventory and plant, equipment and spare parts. This is a welcome development.

However, the Act has yet to address the constraints on export-oriented businesses to declare dividends to its investors. Considering that the intent behind this incentive is to encourage local manufacturing and exportation out of Nigeria, it is important that the provision does not discourage investments by restricting the ability of such companies to distribute profits. Requiring 100% of export proceeds to be reinvested and utilized as contained in the Finance Act removes the ability of investors in such business to reap the rewards of their labour and productivity by sharing or enjoying profits from such export proceeds.

#### 4.1.2 Application of excise duties to excisable imported goods

Prior to enactment of the Finance Act, excise duty (ED) was applicable on excisable goods, such as cigarettes, wines, spirit, beer, stout etc., manufactured in Nigeria.

<sup>3</sup>Nigerian Gross Domestic Product Report Q3 2019

However, such goods when imported into Nigeria does not currently attract ED. The Finance Act seeks to address this disparity by subjecting imported excisable products to ED. Therefore, importers of these products will be required to account for the duty to the Nigeria Customs Service, going forward as required under the Finance Act.

The Act, however, exempts categories of imported goods which are not locally manufactured/available from being charged to excise duties.

#### 4.1.4 Value Added Tax (VAT) compliance threshold

In keeping with global best practice, the Act introduces a VAT compliance threshold of ₦25 million for taxable persons in Nigeria. By implication, Small enterprises with cumulative taxable supplies of less than ₦25 million in a calendar year will not be required to charge output VAT on their invoices or file VAT returns with the FIRS, thereby reducing the compliance burden on such companies.

While this is a welcome initiative, it will potentially affect the cash flow of small manufacturing or trading companies. This is because such companies would be constrained to treat their erstwhile allowable input VAT as an additional business cost, rather than recover it through the input-output mechanism.

Nevertheless, the potential impact of this should be moderated by the tax savings that affected small enterprises would enjoy by virtue of their exemption from CIT.

#### 4.1.5 Expansion of the list of VAT-exempt goods and services

The Finance Act expands the list of VAT-exempt goods in the First Schedule to include locally manufactured sanitary towels, pads and tampons, as well as the following broad categories of “Basic Food Items”:

- a) Brown and white bread;
- b) Cereals including maize, rice, wheat, millet, barley and sorghum;
- c) Fish of all kinds, other than ornamental;
- d) Flour and starch meals;
- e) Fruits, nuts, pulses and vegetables;
- f) Roots such as yam, cocoyam, sweet and Irish potatoes;
- g) Meat and poultry products including eggs;
- h) Milk;
- i) Salt and herbs of various kinds; and
- j) Natural water and table water.

In addition, the Finance Act also expands the list of VAT-exempt services to include tuition relating to nursery, primary, secondary and tertiary education.

The above measures are aimed at alleviating the impact of the increase in VAT rate on the populace.

#### 4.1.6 Tax Holiday for Agric Business

The Finance Act amends Section 23(1) of the CITA to grant tax exemption to companies engaged in agricultural production from tax for a period of five year(s), which can be extended for another three years subject to the determination of satisfactory performance of such business.

However, the Act does not stipulate a framework for granting this incentive, which is probably better placed in the Industrial Development (Income Tax Relief) Act (IDITRA) as an incentive that can be granted by the President on the recommendation of the Nigerian Investment Promotion Council through the Minister for Industry, Trade and Investment.

While the decision to exempt agricultural businesses from tax is a welcome development, it is important that a clear framework for implementation is defined.

## 4.2 Construction Industry

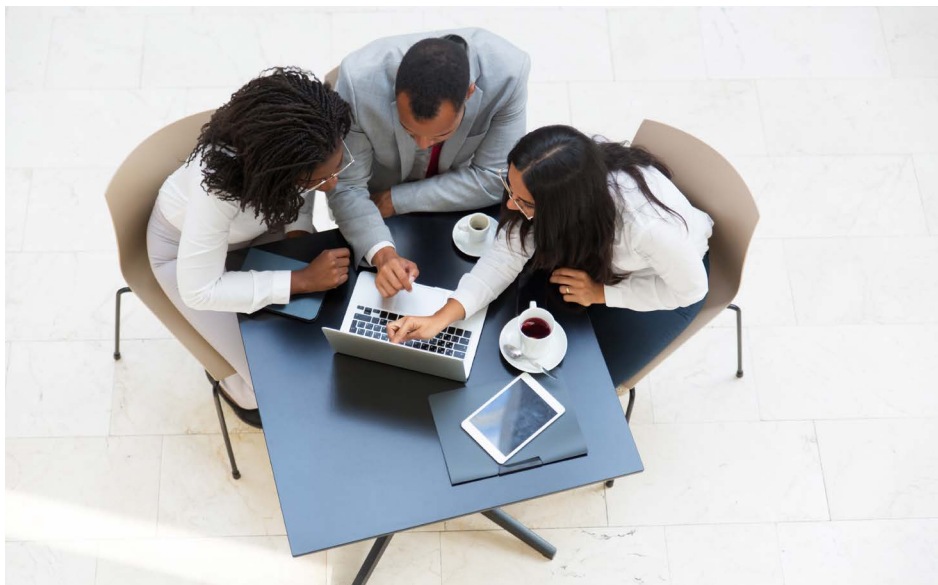
The Finance Act introduces a cap on the withholding tax rate applicable to road, bridges, building and power construction contracts up to a maximum 2.5%. This amendment returns the WHT rate applicable to all aspects of building, construction and related activities (excluding survey, design and deliveries) from 5% to 2.5% following a reversal of the 2.5% rate in November 2016 by a Ministerial Order in the Federal Republic of Nigeria Official Gazette No. 168 issued pursuant to Section 81 of the CITA.

This amendment contained in the Finance Act addresses the challenges of the recoverability of WHT deducted on payments to construction companies due to the thin margins (typically between 2% and 3%) earned by companies operating in this space.

## 4.3 Real Estate Investment Scheme

The Securities and Exchange Commission (SEC) had in 2017 introduced Regulations for the operation of a Real Estate Investment Scheme (REIS) in Nigeria. According to the Regulations, a REIS may be setup as a Trust (Real Estate Investment Trust - “REIT”) or a Company (Real Estate Investment Company – “REICO”).

REISs are investment vehicles which pool funds from investors comprising individuals, companies, pension funds, institutional investors etc. for



investments in real estates, such as airports, housing, shopping malls, etc. as an asset class. REISs are usually established to acquire, develop and hold portfolios of real estate assets, and do not generally hold single assets. While some REISs focus their investment according to geographic location, others are structured to invest in specific property types.

A REIT, being a pass-through entity, would appear to be the more suitable vehicle for operating a REIS from a tax perspective. However, despite the tax benefits of operating a REIT over a REICO, a trust has certain legal constraints that make it unsuitable for the large-scale investments required for financing the development of infrastructure. Due to the variety, size and value of such properties, investors prefer to diversify their risk by acquiring securities or other interests in a REICO, despite the tax limitations of using a company.

The erstwhile tax framework for operating a REICO in Nigeria exposed investors to multiple layers of taxation, arising from receipt and subsequent redistribution of dividends and rent to investors, thereby making investment in a REICO potentially economically unviable.

The tax issues faced by a REICO and the revised provisions contained in the Finance Act are as follows:

#### 4.3.1 Granting REICOs pass-through status

Typically, rental, dividend or any other income received by a REICO on behalf of its investors (beneficiaries) must first suffer tax at 32% (CIT and Tertiary Education Tax) in the books of the REICO, before redistribution to its investors – as dividends. Upon distribution of dividends, a REICO would be statutorily required to deduct 10% WHT.

To manage the double tax risk and ensure each investor is taxed in their various capacities under the relevant tax framework, the Finance Act provides for the treatment of a REICO as a pass-through vehicle. As a pass-through, the REICO would be exempted from paying tax on the income received on behalf of its beneficiaries, whereas the beneficiaries of the income would suffer tax under the relevant tax framework on the income received from the REICO. By so doing, the risk of double taxation is significantly minimised. For clarity, any incomes earned by a REICO other than those collected on behalf of investors would be subject to tax.

#### 4.3.2 Exemption from Excess Dividend Tax

A REICO that earns dividend income that has been subject to WHT, which is considered franked investment income, was predisposed, by virtue of its portfolio structure, to suffer double tax on such dividends in the form of Excess Dividend Tax, upon further redistribution of these dividends to its beneficiaries. Such profits, which would otherwise not have been taxed, are exposed to further CIT at 30%. This means that the dividend income is essentially taxed twice. This risk is especially material since REIS are mandated by SEC to distribute at least 75% of their income.

By amending the CITA provision on “Payment of Dividends by a Nigerian Company” and including an exemption for distributions made by a REICO, this risk, and the obvious disincentive to invest in REICOs, is managed.

A REIS provides a practical, effective and efficient avenue for investing in real estate through the transfer of legal interests and has an enormous impact on economic performance as a result of increased activities in both the capital markets and the real estate sector.

Based on a study conducted on the impact of REITs in the United States, it was estimated that the total economic contribution of the US REITs in 2017 was an estimated 2.3 million full time jobs and \$140.4 billion of labour income. REITs directly employed 265,000 full time employees who earned \$15.2 billion of labour income in the US. REITs also contributed approximately \$19 billion in property taxes in 2017. Clearly, REITs are a significant contributor to the US economy in terms of jobs, economic activities and tax generation. The impact of REITs in other economies, such as South Africa and India, is also worthy of note.



Nigeria is one of Africa's largest economies and the prospects for REIS in Nigeria is perceived to be strong due to the high demand for, and undersupply of, real estate assets, and limited institutional investment. However, the absence of an enabling tax framework had hindered investment in REITs and failed to unlock the potential benefits attributable to REIT activities. It is expected that with supporting tax legislation, a REIS can serve as a tax-efficient "pass through" vehicle for investment in real estate and stimulate growth of the capital markets, the real estate sector and the economy at large.

#### 4.4 Conclusion

The amendments contained in the Finance Act should positively impact companies operating in the CIM industry and thus spur the growth of the industry. The tax-exemption of small companies and the reduced CIT rate for medium-sized businesses, for instance, will increase their capacity to absorb the shocks in the Nigerian macroeconomic environment and improve their cash flow position. These changes, together with the removal of the restriction on carrying forward of losses and the revision of the "commencement rule," will reduce SMEs' risk of failure during the commencement period.

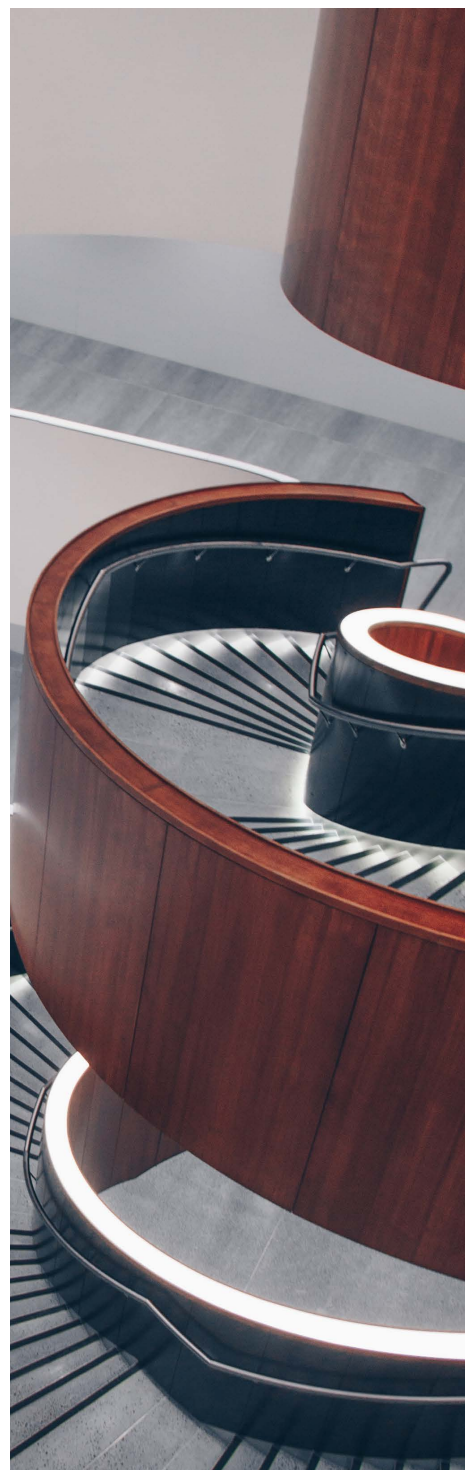
Considering that SMEs generally contribute about 45% of total employment and 33% of GDP in emerging economies<sup>4</sup>, the expectation is that the above incentives would enable Nigerian SMEs to create employment and wealth, thereby reducing the rates of unemployment and poverty in the country, which currently stand at 23.1%<sup>5</sup> and 46%<sup>6</sup>, respectively.

The clarity provided by the Finance Act on the non-applicability of EDT to dividends declared from tax-exempt incomes is also a welcome development for companies whose dividend decisions have been adversely impacted by the literal interpretation of Section 19 of CITA. Also, the EDT-exemption of dividend paid from retained earnings that have suffered tax may encourage some companies to increase the proportion of their current year earnings that is reinvested in the business, thereby reducing their borrowing cost and promoting economic growth and development.

The changes to the conditions for the tax-exemption of export profits may indirectly encourage backward integration and stimulate local demand and capacity building for the production of raw materials, plant, equipment and spare parts that would otherwise have been procured abroad. This may result in increased indigenous and foreign direct investment in the industrial markets sector.

The taxation of foreign service providers, the restriction of interest deductibility and the reduction of the WHT exemption on interest payable on foreign loans are primarily intended to mitigate the risk of base erosion and profit shifting by multinational enterprises operating in Nigeria. However, they may result in a reduction in the volume of foreign services and loans, reduce the amount of foreign exchange required to service them and, ultimately, strengthen the Naira.

On the whole, the Finance Act should result in a significant increase in CIT (from foreign taxpayers), VAT and excise duties, and thus boost government's non-oil revenue. This would, hopefully, reduce the need for increased borrowings to fund the 2020 Federal Government Budget, and change the narrative around Nigeria's dismal tax-to-GDP ratio.



<sup>4</sup><https://www.oecd.org/mcm/documents/C-MIN-2017-8-EN.pdf>

<sup>5</sup>NBS Labour Force Statistics for Q3 2018

<sup>6</sup>Global Multidimensional Poverty Index 2019 by United Nations Development Programme and Oxford Poverty & Human Development Initiative

## 5 Financial Services Industry Impact Analysis



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The financial services industry (FSI) covers a broad range of operations, such as banking, insurance, asset and investment management, payment and credit solutions, etc. The industry typically plays a pivotal role in the development of any economy and Nigeria is not an exception in this regard. Notwithstanding this, despite the strategic nature of the industry, some of its key performance indicators are yet to be met in Nigeria. For example, the insurance sector penetration in Nigeria stands poorly at 0.33% compared to South Africa, Morocco and Kenya which have attained 12.89%, 3.88% and 2.37%, respectively. This gives a broad indication that the Nigerian insurance sector is in dire need of stimulation to contribute to Nigeria's economic growth. While the National Insurance Commission recently issued a directive for the recapitalization of the insurance sector by June 2020, the prognosis is that not many of the current insurance companies can meet up with that deadline. Hence, there have been ongoing waves of business restructuring and reorganisation by insurance companies, possible mergers and acquisitions and more inflow of foreign direct investments are expected in the sector.

The depth of financial intermediation by the commercial banks for the real sector of the economy has been a major concern for the Central Bank of Nigeria (CBN) as highlighted by its recent policy to restrict participation in the open market operations and improve loan-to-deposit ratio to 65% by 31 December 2019. It remains to be seen how this directive will impact the real sector. More so, the recent fall in interest rates for bonds and treasury bills have made the erstwhile lucrative bonds and treasury bills market, where banks invest heavily, less attractive. These interesting dynamics will automatically alter the income profile of many banks who typically have significant investment in these instruments.

Similarly, the microfinance sector has continued to lag in achieving its core mandate of driving financial inclusion among artisans, traders and other small/micro players. Hence, the CBN has issued a directive requiring microfinance banks to recapitalise by April 2020 - 2021 with an objective to deepen financial inclusion and ensure a more vibrant microfinance sector.

The Government has set up several regulatory measures to revamp the Nigerian FSI. While these measures are commendable, it is also important

to address the potentially inimical existing tax law provisions. The Finance Act sets out to do this and we have examined the impact of the relevant provisions on the industry below.

### 5.1 Banking Sector

#### 5.1.1 Requirement to obtain the Tax Identification Number (TIN) of new and existing customers

The Finance Act imposes a requirement on banks and other financial institutions to request the TIN of prospective business customers (companies and individuals), prior to opening any account for their business operations. For continued operation of an account, banks and other financial institutions are required, within three months from passage of the Finance Act, to obtain the TIN of business customers who had not provided this information at the time of opening the account. This requirement is not expected to influence the activation or maintenance of retail bank accounts set up for personal, non-business-related uses.

Banks will typically request for the TIN of companies and registered business names before opening a bank account for them. Therefore, this amendment will simply transform the practice into law and augment government's efforts to bring more businesses into the tax net. The amendment will also extend the practice of the banks to other financial institutions, such as depository, custodial investment and insurance institutions/ companies.

It is interesting to note the impact that this requirement would have on banking activities and how existing accounts without TIN would be regularised and managed going forward. This is particularly as the Act does not stipulate a penalty for failure to comply.

#### 5.1.2 Exemption of services rendered by microfinance banks from VAT

The Finance Act has now modified the VAT Act to clarify the VAT exempt status of services rendered by microfinance banks.

Prior to the CBN's directive in 2005 for all community banks to recapitalise and convert to Microfinance Banks (MFBs), the services of community banks were exempted from VAT in line with the First Schedule to the VAT Act. However, after the statutory mandate to convert to MFBs, there was no corresponding amendment to the VAT Act to confirm the continued exemption to the renamed banks, which have the same objectives as the community banks.

Thus, this amendment is welcomed as it removes the uncertainty and brings a final clarification to the non-applicability of VAT to services rendered by microfinance banks. By implication, services rendered

by unit, state and national microfinance banks will be clearly exempt from VAT. In our view, this will be a win-win for both the government and taxpayers as grassroots taxpayers will enjoy reduced cost of MFB services, and it will inevitably align with the government's drive for financial inclusion.

#### 5.1.3 Amendment of the Stamp Duties Act

The Finance Act amends Section 2 of the Stamp Duties Act to accommodate electronic and digital transactions in the definition of "stamp," "stamped" and "instrument." Based on the provisions of the Finance Act, instrument would now include electronic documents.

The Finance Act also introduces a new section [Section 89(3)] to impose stamp duty of ₦50 on all electronic receipts / transfers of ₦10,000 and above for all types of account. This validates and extends the current practice of banks in this regard and puts an end to ongoing debate on the legality of the stamp duty charged by banks on electronic transfers.

### 5.2 Insurance Sector

The insurance industry has long canvassed for amendments to the taxation framework for insurance businesses under the CITA to bring them at par with other businesses. This is because the erstwhile framework introduced by amendments to CITA in 2007 contained rather onerous provisions for taxation of insurance business, when compared to the tax regime for other businesses. Thus, insurance companies:

- a) were only allowed to carry forward tax losses for a maximum of 4 years of assessment whereas other companies under the same CITA could carry forward their tax losses indefinitely.
  - b) were prohibited from taking a full tax deduction for unexpired risk provision as it relates to their operations in the financial year. Unexpired risk provision is limited to 25% of total premium for marine cargo insurance business and 45% of total premium for other general insurance businesses.
  - c) were required to limit tax deductible claims and other outgoings to 25% of total premium for general business. This is contrary to the general provisions in the CITA that permits companies to claim as tax-deductible all expenses that were wholly, reasonably, exclusively and necessarily incurred for the purpose of generating profit, without limitation.
- The rules on restriction of allowable deductible expenses for insurance companies, inadvertently subjects insurance companies to a deemed minimum tax regime which is contrary to the CITA provisions for determining minimum tax for companies in other sectors.
- d) engaged in life insurance business suffered tax on the investment income and income relating to policyholders thereby resulting in double taxation.



The Finance Act, therefore, repeals the detrimental insurance taxation provisions and replaces them with similar tax provisions applicable to other companies taxable under CITA. We expect that the amendments would improve the fortunes of the insurance industry and make it more viable.

In addition to the above, the Finance Act also introduces a new minimum tax regime for general and life insurance companies which will be computed as 0.5% of gross premium for general insurance companies and 0.5% of gross income for life insurance business, respectively. This has effectively reversed the inequity between insurance companies and other companies taxable under CITA.

However, the Finance Act does not include a specific definition for “gross premium” for the purpose of computing minimum tax for general insurance companies to take into account the peculiar accounting requirements for insurance businesses.

Generally, insurance companies are required to recognise in their financial statements, the amounts customers agree to pay over the financial period (Gross premium written) and the actual amount of these premiums that are earned (Gross premium income) when the insurance company fulfills its performance obligation, typically over time.

Both Gross premium written, and Gross premium income are reflected on the income statement of an insurance company; hence, it is necessary to clearly define “gross premium” for the purpose of insurance minimum tax calculations to avoid ambiguity in the application of this provision.

It is therefore necessary that future review of the Finance Act introduces a definition of Gross premium. This definition should also be reflective of the actual turnover earned by the company, i.e. Gross premium income, to ensure insurance companies are not faced with onerous minimum tax compliance requirements.

## 5.3 Capital Market

### 5.3.1 Exemption of dividend distributed by Unit Trust from WHT

Dividends, being franked investment income, are only subject to 10% WHT as the final tax under CITA. However, while in one vein, CITA exempted dividends distributed by Unit Trusts from WHT, it required Unit Trust companies to deduct WHT on dividends paid to the beneficiaries in another vein. The effect of this was the inadvertent reversal of the tax exemption provided to Unit Trust beneficiaries.

The Finance Act proposes to resolve the conflict in CITA provisions by removing the requirement on Unit Trusts to deduct WHT on dividends paid to their beneficiaries to ensure consistency with the CITA provision exempting distributions to Unit Trust beneficiaries from WHT.

### 5.3.2 Introduction of a tax framework for securities lending transactions

The introduction of securities lending to the stock market in 2012 was an initiative of the capital market regulators to improve market liquidity and boost activities in the stock market.

Securities lending involves a temporary transfer of securities (shares or bonds) from a lender to a borrower. The borrower provides collateral in return for the loan while the lender retains the economic benefits associated with ownership of the loaned securities. The borrower is contractually obligated to return the securities in the final transaction term.

Based on the erstwhile provisions of the law, transactions carried out under this arrangement were taxable based on their legal form, rather

than their economic substance. This created the risk of multiple taxation of the same income streams and thereby made securities lending transactions unviable.

The Finance Act introduces a tax framework that eliminates the multiple taxation risk and ensures that securities lending transactions are taxed based on their economic substance rather than legal form. It is reasonable to assume that capital market operators will take advantage of the new tax framework to ramp up the volume of securities lending transactions on the stock exchange.

Ultimately, the enabling framework for securities lending transactions introduced by the Finance Act should deepen the capital market and raise tax revenue.

#### 5.4 Conclusion

The amendments contained in the Finance Act will significantly impact the FSI. For instance, we expect a significant improvement in the current insurance industry penetration of 0.33% and a boost in the insurance industry growth

rate of 6.69% as at Q3 2019, given that the various onerous provisions in the extant CITA have been addressed by the Finance Act.

Also, the exemption of services rendered by microfinance banks from VAT should significantly improve affordability of microfinance bank services and further improve the rate of financial inclusion which was 36.8% in 2018. This should also translate into improvement in the national gross domestic products (GDP) as more funding should be available for growth of small and medium enterprises through financial inclusion.

The Nigerian FSI grew by 3.72% in nominal terms (year-on-year) and contributed 2.40% to nominal GDP and 2.49% real GDP by Q3 2019. It is expected that the various amendments of CITA by the Finance Act, including those relating to Unit Trusts and Securities Lending, should lead to improvement in capital market activities, increase in government revenue and overall growth of the Nigerian FSI. Overall, the Finance Act is a welcome development for the Nigerian FSI.





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## 6 Oil and Gas Industry Impact Analysis



Ever since crude oil was discovered in Nigeria in 1956, two key issues that have plagued the industry are the seeming opacity of the operations of certain key regulators in the sector, and the alleged unfairness to the country by the international oil companies (IOCs) in their operations. Unfortunately, these concerns were not addressed before more worrying issues surfaced: crude oil theft (which could average as much as 30% of some operators' output), pipeline vandalism/insecurity and uncertainty of fiscal terms (particularly for offshore oil field development).

It is against this backdrop that operators and key stakeholders in the industry have clamored for a complete overhaul of both the regulatory landscape and fiscal framework governing the industry. The outcome was the proposed Petroleum Industry Bill (PIB), which was later split into four Bills – the Petroleum Industry Governance Bill, the Petroleum Industry Fiscal Bill, the Petroleum Host and Impacted Communities Development Bill and the Petroleum Industry Administration Bill. These Bills were at various stages of deliberation by the 8th National Assembly before their tenure ended in May 2019. On

inauguration of the 9th National Assembly, the lawmakers promised to give attention to these issues but, so far, they have only amended one of the pieces of legislation which the PIB was supposed to repeal, the Deep Offshore and Inland Basin Production Sharing Contract (DOIBPSC) Amendment Act. The DOIBPSC (Amendment) Act only sought to increase government's take in oil operation (in particular deep offshore oil field operation) at the expense of government's partners in joint venture/PSC arrangement, most of whom are the IOCs. The amendments introduced a two-tier royalty regime under which deep offshore operators would have to cough out a minimum royalty of 10% on oil production that, hitherto, was royalty-free. It is against this context that we have evaluated the impact of the Finance Act on the oil and gas industry as a whole.

### 6.1 Removal of tax exemption on petroleum profits dividends

The Finance Act revokes the Withholding Tax (WHT) exemption on income or dividends paid out of after-tax petroleum profits, provided for under section 60 of the

Petroleum Profits Tax Act (PPTA). It is important to note that the exemption under section 60 of the PPTA was introduced as a palliative to upstream oil and gas investors whose profits suffer tax at a higher rate of 85% for Joint Venture operations, and 50% for PSCs, compared to the 30% corporate income tax rate applicable to non-oil and gas businesses. Therefore, revoking the exemption will further aggravate the tax burden of the upstream oil and gas companies.

A worsening tax profile for upstream investors, combined with the uncertainties surrounding the Petroleum Industry Fiscal Bill (PIFB) and the impact of the recently enacted DOIBPSC (Amendment) Act, would make the Nigerian upstream sector less competitive and attractive to both foreign and local investors vis-a-vis other oil producing jurisdictions, such as Ghana, Mozambique and Angola, that have substantial oil and gas reserves with lower tax profiles than Nigeria.

## 6.2 Amendment of the Gas Utilisation (Downstream Operations) Incentive provisions

The Gas Utilisation (Downstream Operation) Incentives contained in the CITA confer some benefits on companies in the downstream sector of the Nigerian oil and gas industry. These incentives include a tax holiday for maximum of five (5) years, additional investment allowance and accelerated capital allowance utilisation.

The Finance Act provides for the following amendments:

### 6.2.1 Removal of the requirement to obtain approval from the Minister of Finance prior to claiming interest expense as a deductible expense

The requirement to obtain ministerial approval prior to claiming interest expense as tax-deductible was

viewed as a disincentive by beneficiaries of the incentive. This is because companies operating in other sectors of the economy do not have similar obligations. The removal of this requirement is, therefore, a welcome development.

### 6.2.2 Restriction on the number of tax incentives that can be claimed on the qualifying capital expenditure

The Finance Act clarifies that companies enjoying gas utilization incentives in respect of their qualifying capital expenditure shall not enjoy any other tax incentive including the Pioneer Status Incentive on the same project/assets. By so doing, the Finance Act has limited the potential of further tax revenue loss to the government through a double-dip tax incentive claim.

## 6.3 Conclusion

The main objective of the Finance Act is to raise revenues for the Government through various fiscal measures. The Act has also clarified grey areas in the erstwhile legislation which should help to improve the ease of doing business in Nigeria.

However, for an industry that has not witnessed any significant exploration and development funding in the last decade, the government should rather be developing policies that will boost investment in the Industry. Therefore, while these amendments may increase government revenue in the very short run, the resulting reduction in investors' returns in the short to long term may lead to diversion of the much-needed foreign direct investment to more competitive jurisdictions in Africa.





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## 7 Impact on Business Reorganisations



A business reorganization, such as a merger, acquisition, take-over, asset-deal, etc., which involves a change in ownership and/or transfer of operating assets, will typically trigger tax consequences under the CITA, CGTA and VATA. These may include taxing the proceeds from asset disposal and any transaction profits.

The CGTA provides tax concessions for share-based business reorganisation only. The tax concessions contained under the CITA are applicable only to related-party business reorganisations, subject to meeting certain conditions. Whereas, the VAT does not contain any specific tax provisions on business reorganisations.

As discussed below, the Finance Act seeks to:

- a) harmonise the tax concessions available to related parties undertaking a business reorganisation by introducing similar provisions in the CGTA, CITA and VATA as the basis for enjoying the concessions.
- b) modify the conditions under which the concessions may be enjoyed

and the groups of persons that may enjoy the exemption.

The amendments are discussed as follows:

### 7.1 Introduction of a minimum holding period requirement

The Finance Act introduces a “minimum holding requirement” test for related party group restructuring. Under the revised provisions of the CITA, VATA, CGTA, a company would be recognised as part of a group if such company has been a member of such group for a minimum 365 days prior to the date of the reorganisation. The Finance Act also specifies that any exemption provided shall be withdrawn where the acquiring company fails to hold the underlying assets transferred for less than 365 days after the date of the transaction.

The implication of the above is that short term group relationships created for the

purpose of enjoying the tax concessions would no longer be an effective business reorganisation strategy. Investors will now be forced to consider the cost and benefits of reorganising immediately after an acquisition and forfeiting the tax benefits versus fulfilling the holding period conditions and taking the benefits accorded under the tax laws.

The minimum holding requirement seeks to cultivate a more responsible approach to business reorganisations and limit the concessions to bona-fide commercial transactions. It is expected that tax leakages to the government as a result of artificial reorganisation structures will reduce significantly.

### 7.2 Exemption of assets transferred from CGT and VAT

#### 7.2.1 CGT concession

Chargeable gains on business reorganisations are exempted from CGT to the extent that the consideration



for any shares disposed of pursuant to a business reorganisation is non-monetary. No concessions are provided for assets transferred in a business reorganisation.

The same CGT Act also exempts gains on disposal of shares from CGT, regardless of whether the consideration for such disposal is monetary or non-monetary. Based on this, the utility of the first mentioned exemption had hitherto been questioned, given that there is a general exemption for any transaction in share.

The Finance Act modifies the tax exemption on business reorganisations which exempts assets transferred in a related-party business reorganisation, subject to passing the minimum holding requirement test. Operating assets transferred in the course of a related-party business reorganisation will typically not give rise to the realisation of economic value for group of companies, as the benefits

derived from utilising those assets will eventually devolve to the same persons who had hitherto benefited from those assets. Taxing the asset transfer would, therefore, result in a double taxation within the group on the same asset as opposed to taxing the synergies and other economic benefits derived from exploiting those assets.

The implication of the above amendment contained in the Finance Act is that, related-party business reorganisations can now be successfully completed in a tax-neutral manner – subject to passing the minimum holding requirement test.

#### 7.2.2 VAT concession

The Finance Act also provides the same exemption for assets transferred in a related-party business reorganisation in relation to VAT.

In view of the expanded definition of “goods”

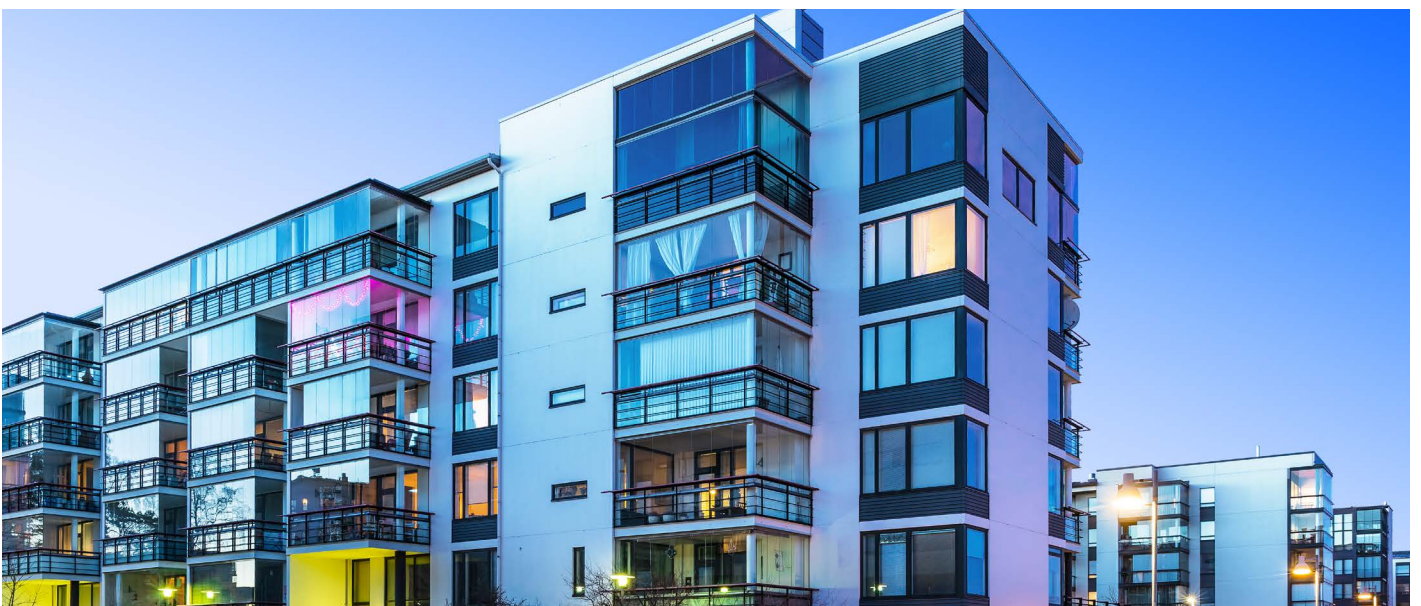
under the Act, high-value goods, such as buildings, trademarks/tradenames, securities, etc., that would otherwise have been subjected to VAT at their transfer value, will now enjoy tax-exemption, subject to passing the minimum holding requirement test.

#### 7.3 Definition for recognised group of companies

The Finance Act provides a definition for recognised group of companies to mean “a group of companies as prescribed under the relevant accounting standard”. This definition clarifies the category of companies that may enjoy the exemptions contained in the CITA, VATA and CGTA.

#### 7.4 Conclusion

The changes contained in the Finance Act relating to related party reorganisation will impact the way business restructurings are consummated going forward. Investors would therefore need to pay attention to the impact of these changes on their acquisition strategy.





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## 8 Impact on the Digital Economy



Technological changes are constantly shaping business relationships and organizations have continued to refine their business models to keep up with digital innovations. However, tax has not kept pace with the digital revolution and collective attempts are just being made globally to catch up with the fast-changing pace of the digital economy.

According to the Organisation for Economic Cooperation and Development (OECD)'s Action 1 on preventing Base Erosion and Profit Shifting (BEPS), digital economy is characterized by massive use of data, unparalleled reliance on intangibles, difficulty in determining the jurisdiction in which value creation occurred, little or no physical presence required for value creation or service delivery, etc. To address the tax challenges of the digital economy, the OECD, through its BEPS Inclusive Framework, has proposed the following approaches for allocation of taxing rights and nexus rules, for consideration by its members:

- a. User Contribution – which allocates taxing rights by focusing on user base for digital services, data and content generation in a highly digitized business.

- b. Marketing Intangibles – this has a broader application by focusing on aspects of commercial exploitation of a product or service, and includes trademarks, customer list, proprietary market, etc.
- c. Significant Economic Presence – this allocates taxing rights based on evidence of a combination of factors that create purposeful and sustained interaction with the economic life of a jurisdiction through digital means.

However, the approaches are still being debated, and OECD has up till December 2020 to conclude its work on the new architecture for corporate income tax.

Regarding the applicability of VAT to digital/electronic transactions, Nigerian courts have before now been tasked to fill the gap in extant Nigerian tax legislation by ruling (such as in *Vodacom Business Nigeria Limited vs FIRS*; Appeal no. CA/L/556/2018) that such transactions are liable to VAT. Therefore, the legislative intervention by the Finance Act to address the uncertainties around taxation of digital economy in Nigeria is a welcome development that brings clarity to this area of Nigerian tax laws.

### 8.1 Establishment of Digital Permanent Establishment for Companies Income Tax

The Finance Act introduces new provisions under the CITA aimed at, among other things, capturing the digital economy by adopting “significant economic presence” (SEP) to affix the affected companies with a fixed base in Nigeria.

Prior to the Finance Act, Section 13 of the CITA subjected a Non-resident Company (NRC) to tax in Nigeria only if such company had a fixed base in Nigeria and the taxable profit was the profit attributable to that fixed base. A fixed base may be created by the physical presence of an NRC's employees in Nigeria, an arrangement with a dependent agent who executes transactions on behalf of the NRC in Nigeria, the execution of a single contract for surveys, deliveries, installations or construction by the NRC in Nigeria, or existence of an artificial or fictitious transaction involving related parties in Nigeria. Hence, the nexus for taxing profits derived by a foreign company in Nigeria is based on physical presence in Nigeria.

Accordingly, the profits derived by non-resident digital businesses from online activities, such as advertising, movie streaming, online gaming stores, e-commerce, etc., from their users/subscribers in Nigeria were outside Nigeria's tax net. The direct consequence of this was tax revenue leakage for the Nigerian Government.

To address the challenges of taxation of the digital economy, the Finance Act introduces SEP to create a nexus for taxing profits derived by NRCs from digital operation in Nigeria. The amendments provide that the “profits of a company other than a Nigerian company from any

trade or business shall be deemed to be derived from Nigeria if it transmits, emits or receives signals, sounds, messages, images or data of any kind from cable, radio, electromagnetic systems or any other electronic or wireless apparatus to Nigeria in respect of any activity, including electronic commerce, application store, high frequency trading, electronic data storage, online adverts, participative network platform, online payments and so on, to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity.”

The implication of this amendment is that affected NRCs in e-commerce, filming, computing, ride-hailing, media, etc., who previously had no fixed base in Nigeria under the conventional rules, and no Nigerian tax obligations, will be liable to Nigerian income tax provided they meet the SEP threshold. Also, such NRCs may be required to register for taxes and file income tax returns in Nigeria in line with Section 55 of CITA.

The Finance Act vests the Honourable Minister of Finance (MoF) with the power to issue an Order on SEP. On this basis, it is expected that the tax regime for the digital economy introduced by the Finance Act will only become effective after the Order has been issued. As this is a matter of global importance, it is expected that the MoF will leverage guidelines provided by the OECD’s BEPS Action Point 1 in determining what constitutes SEP for the purpose of an NRC deriving digital income from Nigeria. According to the OECD guidelines, SEP principle allocates taxing rights based on evidence of a combination of factors that create purposeful and sustained interaction with the economic life of a jurisdiction via digital means. The factors include

revenue generated on a sustained basis, existence of a user base, maintenance of website in a local language, volume of digital content generated from the jurisdiction, etc.

### 8.2 Introduction of Place of Supply rules for VAT

There had been uncertainties in the application of the provisions of the VATA to cross border services. For instance, while the extant VATA contains definitions of “exported services” and “imported services”, it does not have provisions relating to the “place of supply”. This has led to civil suits between taxpayers and the tax authority on whether the Nigerian VAT Act is based on the “origin principle” or the “destination principle”. The origin principle holds that goods and services are liable to VAT in the jurisdiction where value is created (i.e., where goods are produced and services are rendered), however, under the destination principle VAT is chargeable in the jurisdiction where goods and services are consumed.

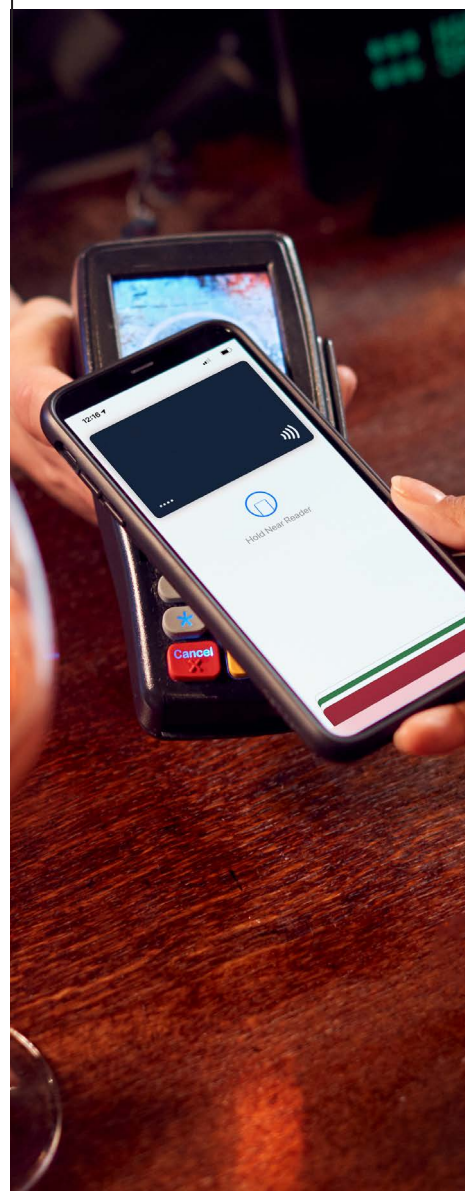
The Finance Act seeks to resolve this issue by introducing “place of supply” rules in the definition of “services” and “exported services” and also adopts the destination principle which aligns with the OECD’s VAT/Goods and Services Tax international tax principles. From the effective date of the Finance Act, services received by a person resident in Nigeria will be chargeable to VAT, regardless of the location of the supplier.

The Nigerian recipient of a VATable service provided by an NRC will also be required to self-account for the VAT where the NRC has not included VAT in its invoice.

### 8.3 Conclusion

The amendments aimed at taxation of the digital economy in Nigeria aligns with global trends and provide more certainty on liability of cross-border transactions to VAT in Nigeria.

The anticipated significant impact of the amendments on the affected businesses makes it necessary for them to review their commercial arrangements for the purpose of compliance or restructuring.



## 9 Conclusion

Amendment of tax laws during annual budgetary process through the Finance Act is a laudable development that will assist to implement several important long-awaited changes to the Nigerian taxation framework. The Finance Act would stimulate economic activities and bolster investor confidence, provide the long overdue clarity on hitherto controversial tax issues and create an opportunity for raising the much-needed tax revenue in a more efficient and equitable manner that encourages economic growth and development.

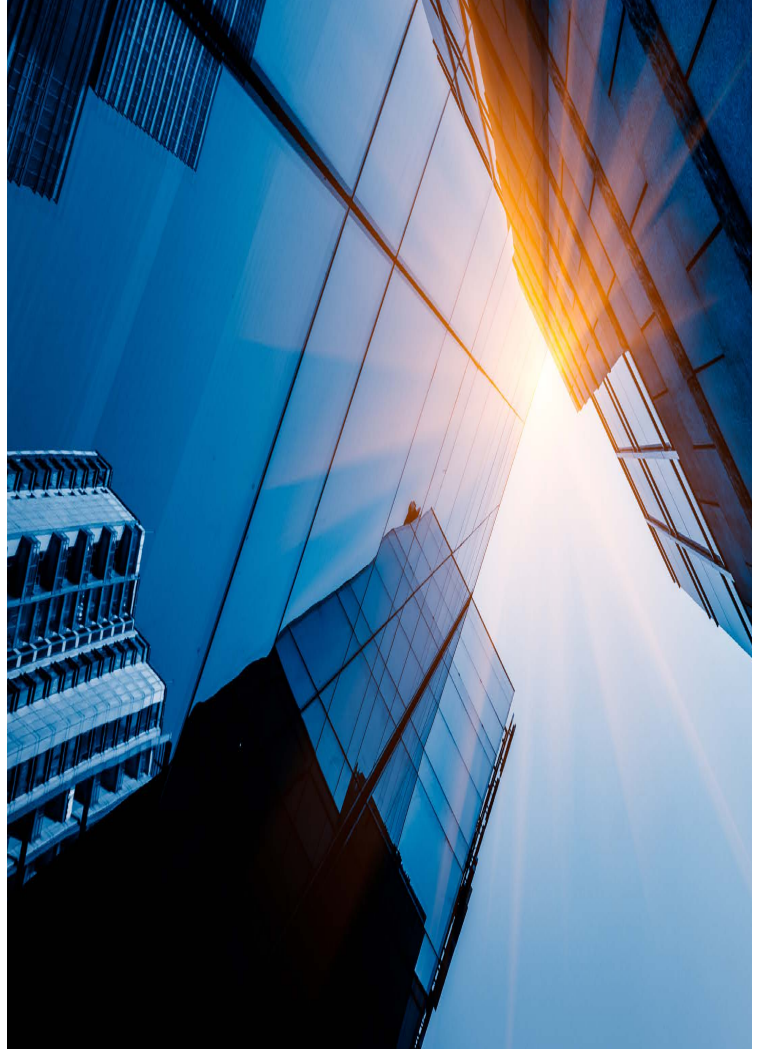
One of the more interesting expectations from the Finance Act is its positive impact on SMEs in Nigeria. In our view, the incentives provided to the SME sector are appropriate considering that the National Bureau of Statistics data shows SMEs as employing about 84% of Nigeria's labour force, whilst contributing about 50% of the number of industrial jobs. The sector has been variously described as the engine room for Nigeria's development and industrialization and accounts for about 48% of GDP. Granting tax concessions provides them with a significant reduction in reporting complexities and frees them up to deploy additional capital into their business. These palliatives will result in greater employment opportunities across board whilst allowing the tax administration focus its additional resources towards harnessing tax revenue from the sectors of the economy that have the largest revenue footprints.

It may also be the right time for companies to re-imagine their tax function to ensure that it is sustainable into the future through the right blend of efficiency and effectiveness in delivering tax planning, compliance management and resource utilisation. Therefore, a tax function review/workshop, to validate the "fit for purpose" test and determine improvements required, may be essential. The time to act is now!



# Glossary of key updates

- (a) Revision of commentary in Section 2.2.8 relating to the increase in applicable penalties for late payment of taxes and filing of tax returns.
- (b) Additional commentary in Section 3.1.6 on the imposition of requirement for all customers to self-account for VAT.
- (c) Revision of commentary in Section 3.1.6 relating to requirement for non-resident companies to register for VAT.



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