Matters Arising from Implementation of Finance Act, 2019
<table>
<thead>
<tr>
<th>Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preface</td>
</tr>
<tr>
<td>Introduction</td>
</tr>
<tr>
<td>1 Implementation of the Value Added Tax (VAT) provisions of the Finance Act, 2019</td>
</tr>
<tr>
<td>2 Tax implications of the operation of Regulated Securities Lending Transaction (SEC Lending) in Nigeria</td>
</tr>
<tr>
<td>3 Sundry provisions of the Finance Act 2019 as it relates to Companies Income Tax Act (CITA)</td>
</tr>
<tr>
<td>4 Provisions of the Stamp Duties Act</td>
</tr>
<tr>
<td>5 Commencement and Cessation Rules, and Business Reorganisation</td>
</tr>
<tr>
<td>6 Tax implications of operation of Real Estate Investment Companies (“REIC”) in Nigeria</td>
</tr>
<tr>
<td>7 Amendments to Section 16 of CITA in relation to taxation of Insurance Companies</td>
</tr>
<tr>
<td>Conclusion</td>
</tr>
<tr>
<td>Appendix</td>
</tr>
</tbody>
</table>
Preface

For many reasons, the Finance Act, 2019 will remain a watershed in Nigeria’s fiscal history for a long time to come. It is the first attempt at comprehensive review of Nigeria’s tax laws, which have been long overdue for reform, and the first Finance Act to be enacted by the National Assembly since return to democracy in 1999.

We have comprehensively reviewed the vast changes to the extant tax laws by the Act and analyzed its impact on taxpayers in various sectors of the Nigerian economy in our book, Finance Act, 2019: Impact Analysis, published in February 2020.

In April 2020, the Federal Inland Revenue Service (FIRS), commendably, issued various Information Circulars to provide clarifications to taxpayers on the provisions of the Act amending the extant tax laws.

Whilst timely and welcome, the Information Circulars raise such fundamental issues on the implementation of the Act that we have considered it necessary to dedicate a chapter each in this publication to commentaries on each Circular. For quick reference by readers, we have provided the weblink to each Information Circular at the end of each Chapter of the publication and in the Appendix thereto.

We sincerely hope that the FIRS will consider the commentaries in this publication and revise the incongruous provisions of some of the Circulars to bring them into conformity with the provisions of the Act.

As usual, we welcome feedback from our readers who can reach us by email to ng-fmtaxenquiries@ng.kpmg.com.

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Introduction

The Federal Inland Revenue Service (FIRS or “the Service”) in May 2020 issued the following Information Circulars numbered 2020/02 - 08 (“the Circulars”):

2. Circular on Tax Implications of the Operation of Regulated Securities Lending Transaction (SEC Lending) in Nigeria (“SEC Lending Circular”);  
3. Clarifications on Sundry provisions of the Finance Act 2019 as it relates to Companies Income Tax Act (“CITA Circular”);  
5. Clarification on Commencement and Cessation Rules, and Business Reorganisation: - Sections 29 of CITA, 32 of CGTA and 42 of VATA (as amended by the Finance Act, 2019) (“Business Reorganisation Circular”);  
6. Circular on Tax Implications of Operation of Real Estate Investment Companies (“REIC”) in Nigeria (“REIC Circular”); and  
7. Clarification on the Amendment to Section 16 of Companies Income Tax Act (CITA) in Relation to Taxation of Insurance Companies (“Insurance Taxation Circular”)  

The Circulars are aimed at providing guidance to stakeholders on the interpretation of the amendments to extant tax laws by the Finance Act, 2019 (“Finance Act”), and practical issues associated with their implementation. The Circulars supersede any previously issued circular, notice or publication by the FIRS, which is inconsistent with the Circulars to the extent of its inconsistency.

We commend the FIRS for the timely issuance of the Circulars to assist taxpayers to understand their obligations under the various tax laws amended by the Finance Act and further improve their compliance with the laws. The Circulars have also clarified the FIRS’ views on some contentious provisions introduced by the Finance Act.

However, there are matters arising from the clarifications and guidance provided in the Circulars that may have unintended consequences. This publication contains analysis of those issues and highlights key areas requiring further clarifications from the FIRS.
The VAT Circular provides guidance on the interpretation of the amendments to the VAT Act by the Finance Act, and practical issues associated with its implementation. The key issues from the VAT Circular are discussed below:

### 1.1 Definition of Goods and Services

The Finance Act expands the definition of “goods” to include both tangible and intangible goods. Although examples of “tangible” goods or properties were not provided, the Finance Act provides guidance that such properties must be **movable at the point of supply**. Hence, it is not clear why the FIRS included building and roads as goods that are liable to VAT in its Circular. Buildings and roads, by their nature, are not movable and their sale or transfer should, therefore, not qualify as “goods” for the purpose of VAT. As a building is not movable, a lease of the building should not qualify as an intangible good for VAT purpose. Interest or right in building and roads is very similar to interest in land, which is exempt from VAT, and should equally not qualify as goods under the VAT Act.

### 1.2 Transitional Issues

The VAT Circular provides that the time of supply or performance of service shall be the major determinant of applicable VAT rate for taxable supplies made during the transition period. Accordingly, a service is deemed to have been supplied for VAT purpose upon performance of the service, achievement of agreed milestone, and delivery or transfer of risk (whichever occurs first). Consequently, contracts for taxable supplies that were signed and performed prior to 1 February 2020, but invoiced after that date, will attract the old rate of 5%. Therefore, taxpayers should keep relevant documents to substantiate the date of supply to avoid situations where the tax authority may rely on the invoice date to charge the new 7.5% VAT rate on such transactions.

While contract for taxable supplies executed after 1 February 2020 will certainly attract 7.5% VAT rate, taxpayers will need to consider a combination of factors, including the date the contract was signed, when the supply was made, and the dates specified on invoices, bill, journal entries, etc., to determine the appropriate VAT rate to apply to their transactions that fall within the transition period.

### 1.3 Self-accounting Provision

The introduction of self-accounting provision in the VAT Act has expanded the scope of VAT compliance in Nigeria by imposing the duty to remit the VAT on taxable supplies on the buyer where the seller is not statutorily required to charge VAT, or is required but failed to include the tax on its invoice.
Therefore, failure by the taxable supplier to charge VAT, and the taxable buyer to self-account for the tax on taxable supplies will result in consequences for both the supplier and buyer. However, the tax authority must not enforce the law in a manner as to require both the buyer and the seller to simultaneously account for the principal amount of the VAT liability in the event of an audit.

Further, as persons who transact business with suppliers below the VAT compliance threshold will now be required to account for the VAT, that would otherwise have been accounted for by such suppliers, it is not certain whether the “self-accounting” rule will apply to transactions between two persons who are exempt from VAT compliance.

Therefore, the tax authority is required to provide further clarity on these matters to ensure that taxpayers are not unduly punished.

1.4 Determination of ₦25 million turnover threshold

Although companies with taxable supplies below the ₦25 million threshold are not required to charge, collect, remit and file monthly VAT returns, they are mandated by law to register with the FIRS. Given that such companies are required to begin to account for VAT at any time during the year when they achieve a cumulative ₦25 million taxable supplies threshold, both the suppliers and the FIRS must have a systematic means of determining when the threshold is reached. This will ensure that such companies are not subjected to penalties for not accounting for VAT in periods during the year when they traded below the threshold.

Requiring voluntary VAT compliance by taxable persons below the threshold may be beneficial for both the government and the taxpayer. Firstly, it is expected to ease VAT administration as the FIRS can concentrate on the suppliers who are easily identifiable, rather than the buyers who may be outside the tax net. Secondly, although the exemption will reduce the compliance burden on such companies, affected suppliers can better manage their cashflow by charging VAT and offsetting valid input VAT suffered, that would otherwise have been expensed, against the output VAT collected before remitting the net amount to the FIRS.

Please click here to read and download the VAT Circular.
Tax implications of the operation of Regulated Securities Lending Transaction (SEC Lending) in Nigeria

The SEC Lending Circular provides clarity on the recently introduced provisions on Securities Lending in the Finance Act in relation to the CITA and Stamp Duties Act, Cap C8, Laws of the Federation of Nigeria (LFN) 2004 (as amended). The key issues from the SEC Lending Circular are discussed below:

2.1 Clarity on the nature of Regulated Securities Lending Transaction

The SEC Lending Circular provides general guidance on what constitutes a regulated securities lending transaction. This guidance is provided by leveraging the Securities and Exchange Commission (SEC) Rules on securities lending transactions. A noteworthy point in the Circular is clarification on the requirement for the Borrower and Lender, in a securities lending transaction, to conclude their transaction through an intermediary agent and without any direct contact with each other. This clarification is consistent with the current SEC Rules on securities lending arrangements. However, the requirement for an intermediary agent is not mandated by the Finance Act.

In the absence of the definition of “collateral” in the Finance Act, the FIRS has included a definition of the term in its Circular. The FIRS’ definition is based on SEC’s definition in its Rules and, in our view, is a useful inclusion in the Circular.

The above clarification provided by the FIRS is useful, but not a restrictive guidance, and remains relevant only to the extent that the SEC Rules continue to permit. This is consistent with the requirement under the Finance Act to determine qualifying securities lending transaction with reference to the applicable SEC Rules at each time.

2.2 Taxation of Income on Securities Lending

The SEC Lending Circular clarifies the cashflows and income streams applicable in a typical securities lending transaction and guidance on the CIT (and withholding tax (WHT)) treatment thereof. Essentially, income streams (other than compensating payments), such as actual dividends, interest, rights, bonus and redemption benefits, earned in the course of a regulated securities lending transaction, will be liable to tax in accordance with the relevant provisions of CITA.

Furthermore, the SEC Lending Circular clarifies:

- the non-taxable/non-deductible nature of compensating dividend payments and the deferral of taxes (with exception of WHT) on compensating interest payments until received by the Borrower.
- the role of an intermediary agent as a pass-through entity in a regulated securities lending transaction, with the singular tax obligation of deducting WHT on interest payments made to the Borrower; and the exemption of regulated securities lending transaction from application of stamp duties.

However, the SEC Lending Circular suggests that compensating interest payments made by a Lender to an Agent or Borrower would not qualify as a tax-deductible expense in the books of the Lender. This position is contrary to the provisions of Section 24(1) (l) of the CITA (introduced by the

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1Paragraph 389 of the Consolidated SEC Rules and Regulations 2013 provides the general requirements for securities lending transactions.
In addition to being contrary to the clear wording of the law, the FIRS’ suggestion, if applied, will result in clear tax leakages across the securities lending value chain, which is not the intention of the lawmakers.

2.3 Other Comments

In general terms, the SEC Lending Circular adequately highlights the key issues around SEC Lending transactions and the tax implications thereof. By leveraging the SEC Rules and providing additional guidance on terms used in the Finance Act, the Circular constitutes a useful frame of reference for providing taxpayers with insights on securities lending. However, the FIRS should revisit its proposed restriction on the deductibility of compensating interest payments made by a Lender to an Agent or Borrower.

The fundamental objective of the amendments in the CITA, as it relates to securities lending, is to limit or otherwise eliminate the risk of multiple taxation on the same income stream in a single transaction. In the case of interest payments, the ultimate tax obligation lies with the Borrower. Hence, the Lender (and Agent) should not be worse off by virtue of participating in the transaction. Therefore, while the law allows for the gross interest payments to be taxed in the hands of the Lender, it also permits such Lender to take a tax deduction for the portion of such interest paid out in the form of “compensating payments.” In effect, the Lender should suffer no additional tax liabilities to the extent that all interest earned on the collateral is passed on to the Borrower.

Please click here to read and download the SEC Lending Circular.
The CITA Circular provides guidance on sundry provisions of the Finance Act that relate to the CITA. Below are the key issues from the CITA Circular:

### 3.1 Section 19 of CITA on Payment of Dividends by a Nigerian Company

The Finance Act has resolved the controversies regarding imposition of dividend tax based on Section 19 of CITA by exempting the following income from tax under the provision even when the profits that generated such dividend relate to prior tax years:

i. Dividends paid out of retained earnings of a company, provided that the dividends are paid out of profits that have been subjected to tax under the CITA, Petroleum Profit Tax Act (PPTA) or the Capital Gains Tax Act (CGTA);

ii. Dividend paid out of profits that are tax-exempt pursuant to the CGTA, PPTA & Industrial Development (Income Tax Relief) Act (IDA) or any other legislation;

iii. Franked investment income under the CITA; and

iv. Distributions made by a Real Estate Investment Company to its shareholders from rental or dividend income received on behalf of those shareholders;

The FIRS introduced a “Last-in First-out” (LIFO) approach for the purpose of retained earnings analysis by deeming dividends to be declared, first, from the current year profits (disclosed in the financial statements) before considering prior years’ profits transferred to retained earnings. With this approach, the dividends deemed to have been declared from current year’s profits will then be subject to excess dividend tax (EDT).

However, there is no provision in the Companies and Allied Matters Act or any other Act that supports the LIFO position of the FIRS on dividends declaration. In fact, the Finance Act refers only to retained earnings and does not differentiate between its components, provided the related profits have previously been subjected to tax. It should also be noted that, based on accounting standards, current year’s profits...
and other comprehensive income are transferred to the consolidated statement of changes in equity from where dividend distribution is subsequently made. In other words, dividends can only be distributed from retained earnings as of the time of declaration. There is, therefore, a high probability that taxpayers can successfully challenge the FIRS’s position to subject dividends deemed to have been distributed from current year’s profits to EDT.

3.2 Section 27 of CITA on Expenses Incurred in Earning Exempt Income

The FIRS introduced an approach based on “business-activity” level to uniformly separate expenses incurred in deriving exempt income from those related to non-exempt income. While it may be understandable to use income level to derive associated expenses, this prescription should not be imposed on all businesses. This is particularly true as the Finance Act does not stipulate a measurement of income to expense for the purpose of determining deductible or non-deductible expenses.

It is instructive that the Finance Act merely disallows expenses relating to exempt income. Thus, the determination of allowable expenses should not be by derivation but fact-based. Consequently, taxpayers should be able to conduct a self-assessment or evaluation of the actual amount they incur to earn exempt income and disallow such expenses for tax purposes only. This approach is more aligned to the intention of the Finance Act and follows the typical manner of treating other category of expenses for tax purposes.

In order to ensure the reasonableness of actual expenses relating to exempt income that taxpayers present, the FIRS may utilize ratios to guide itself and its staff during tax audits and reviews. However, rather than using a general or blanket ratio for all companies, the FIRS must consider the peculiarity of each taxpayer, the industry cost structure and other related factors to establish benchmarks for estimating the acceptable amount of expense incurred in earning tax exempt income.

3.3 Exemption of Small Companies from Income Tax

The profits of small companies (being companies with a gross turnover of ₦25 million and below) are exempt from tax, in line with amendments introduced by the Finance Act to Section 23(1)(o) of CITA.

The FIRS’ positions that small companies are required to register for taxes and file tax returns promptly, and that failure to comply with these requirements will expose such defaulting company to penalties, are in the right direction. However, the Finance Act does not support FIRS’ view that such default will result in the forfeiture of the exemption from income tax. In fact, the Finance Act is very explicit about this with the use of the phrase ‘without prejudice to this exemption’. In other words, there should be no prejudice to the right of a small company to tax exemption simply because it has not registered or filed tax returns. Rather, such taxpayer will be subject to the applicable penalties for such default.

3.4 Withholding Tax Obligations

The position of the FIRS requiring companies to deduct tax from payments due to small companies is understandable given the difficulty of ascertaining whether a party in a business arrangement is a small company as of the time of the transaction. However, the FIRS must ensure a seamless process of tax refund to such small companies by ensuring that the refund is made within 90 days of application in line with Section 23(4) of the FIRS (Establishment) Act, 2007, irrespective of whether an audit has been concluded or not. This will provide small business owners with the cash they need to grow their businesses. The audit can be conducted later, and any additional payment that may arise from the failure to deduct and remit relevant taxes withheld can be assessed and collected at that time.

3.5 Treatment of Capital Allowances for Small Companies

According to the CITA Circular, capital allowances (initial and annual allowances), which would have been available to small companies during the years of assessment in which their profits are tax exempt, will be deemed to have been fully utilized during the tax-free period. The FIRS claimed to have based this position on...
Sections 24 and 27(1)(h) of the Finance Act. However, there is no reference to capital allowances in these provisions relied upon by the FIRS. There is, therefore, no legal basis for the position that the capital allowances due to a small company would have been deemed utilized. Rather, the FIRS should adopt the same position with respect to pioneer companies to the effect that the capital expenditure incurred during the tax-exempt period is deemed to have been incurred on the day such business becomes taxable. Where a small company has already started claiming capital allowances prior to the commencement of the Finance Act, any unutilized capital allowances should become available on the day it becomes subject to tax.

Further, the FIRS’ position is contradictory to its stance on the applicability of tertiary education tax (TET) to small companies. As the FIRS already alluded to the fact that TET will not be applicable as tax exempt companies do not have assessable profits, a company without assessable profits cannot be deemed to have utilized its capital allowances against such profits.

3.6 Interest Deductibility Rule

The Finance Act introduces the interest deductibility rule (i.e., the restriction of deductible interest expense to 30% of earnings before interest, tax, depreciation and amortization (EBITDA)) for loans obtained from foreign connected persons. The FIRS’ position on this is that interest expenses incurred by relevant companies should comply first with the provisions of the Transfer Pricing Regulations before the application of the deductibility rule. The FIRS also defines EBITDA to mean assessable profits before interest expense. However, while the Finance Act does not define EBITDA, its meaning is not in dispute. It is a finance or accounting term that means earnings before interest, tax, depreciation and amortization. Earnings simply refer to accounting profits. It, therefore, cannot mean assessable profits which refer to accounting profits adjusted for tax purposes.

Further, the FIRS states that interest due to third parties will be considered for the purpose of determining the maximum interest deductible for taxes. According to the CITA Circular, interest and deductions of similar nature means “the cost of borrowing money or other financial charges. It includes interest, discounts, fees, premium, share of profit, finance cost element of finance lease or foreign exchange losses that are paid or payable in relation to a loan or a debt, or any other payment in relation to derivatives used in hedging a loan or debt.” On the contrary, the Finance Act is very explicit on the application of the interest cap to only interest on loans from foreign connected parties, excluding interest on loans from third parties, except where such third parties have received guarantees from related parties for the provision of such loans.

3.7 2020 Year of Assessment (YOA) Income Tax Returns

The Finance Act became effective on 13 January 2020. The FIRS clarified that the provisions of the Finance Act will not affect 2020 YOA income tax returns that were due before the commencement of the Finance Act. Therefore, those returns are not required to be prepared or adjusted to comply with its provisions. The implication of this is that only companies whose accounting years end from July 2019 will need to prepare and submit their income tax returns in line with the amendments introduced by the Finance Act. This position is consistent with what generally obtains in practice, especially where no transitional rules are included in an Act. However, the dispute and controversy generated would have been avoided if the enabling law had specified the transitional rules and the applicable accounts as it is usually the case with new accounting standards.

3.8 Minimum Tax

In the Circular, FIRS has defined “gross turnover” to include “all operating incomes or revenues anywhere embedded.” Consequently, the illustration provided shows that all incomes reported in the financial statements, except for franked investment income, are subject to minimum tax.

However, incomes are generally classified in the financial statements as operating, financing, investing or other incomes. Operating income represents income from a company’s main revenue-producing activities. Consequently, any income that does not form part of operating income should not be subject to minimum tax. Had the legislature intended for all incomes to be subject to minimum tax, it would have been explicitly stated.

Please click here to read and download the CITA Circular.
The Stamp Duties Circular provides guidance on the interpretation of the amendments to the Stamp Duties Act (SDA) Cap S8, LFN, 2004. Though the Circular has clarified the FIRS’ interpretation of the amendments introduced by the Finance Act, the Stamp Duties Circular also contains FIRS’ views on some of the existing provisions of the SDA, such as the scope of dutiable instruments and their associated stamp duty rates. The key issues from the Stamp Duties Circular are discussed below:

**4.1 Stamp Duties on Electronic Documents**

The Finance Act expands the definition of “dutiable instruments” to include electronic documents. Examples of electronic instruments cited include agreements drafted and executed online without any physical document, e-mail correspondence communicating the terms and conditions of an agreement, etc. Furthermore, the Stamp Duties Circular extends the interpretation of “receipts” to include electronic documents received in Nigeria may result in double taxation, especially in instances where such documents might have been stamped in the other country, if similar stamp duty laws exist there.

The provision may, therefore, result in an unintended double imposition of the duty on the same instrument.

**4.2 Stamp Duties on Electronic Documents received in Nigeria**

The Stamp Duties Circular expounds the meaning of “documents executed outside Nigeria but received in Nigeria” to include electronic documents, receipts or instruments:

- retrieved or accessed in or from Nigeria;
- (or an electronic copy) stored on a device (including a computer, magnetic storage, etc.) and brought into Nigeria; and
- (or an electronic copy) stored on a device or computer in Nigeria.

The FIRS’ attempt to clarify electronic documents received in Nigeria may result in double taxation, especially in instances where such documents might have been stamped in the other country, if similar stamp duty laws exist there.

**4.3 Stamp Duties on Bank Deposits or Transfers**

The Finance Act modifies the SDA and legalizes the charge of stamp duties on electronic receipts, including the charge of ₦50 stamp duties on bank deposits and transfers. The Stamp Duties Circular provides that the duty is to be remitted to the FIRS using the automated stamp duty process to be provided by the Service. This would cover stamp duties on bank deposits or transfers of ₦10,000 and above, on a going forward basis.

Regarding the proposed automated stamp duty process, we are aware of the infrastructural challenges and technology limitations in Nigeria, which include network downtime, limited digitization of tax administration, etc. This will require investment by the FIRS in a good electronic tracking mechanism for data collection. Thus, the success of the...
automated stamp duty process will depend on how quickly the FIRS can digitize its data capture and audit process.

4.4 Stamp Duties on Contracts

The FIRS clarifies that all corporate entities including Ministries, Department and Agencies are required to charge and remit 1% of the contract value (excluding VAT) as stamp duty on all contracts issued to third party vendors.

This clarification is, however, at variance with the provisions of the SDA, which provide specific rates for different types of contracts, e.g., leases (see below); mortgages at ad-valorem rates ranging from 0.075% to 0.375%, and sale of property at 1.5% ad-valorem rate. Also, the SDA provides that any other contract not specifically charged with any duty will be charged with a flat rate of 15 Kobo.

In addition, the imposition of the duty on all contracts issued to third party vendors is far-reaching and, again, conflicts with the provisions of the SDA which grants exemptions to certain contracts, such as agreements relating to the sale of goods, wares, merchandise, etc.

Further, the rate of 1% of contract value specified in the Stamp Duties Circular is not supported by the SDA. Therefore, there is need for the FIRS to review and revise its pronouncement on the application of stamp duties on contracts/agreements, in general.

4.5 Stamp Duties on Loans, Credit Facilities and other instruments

The Stamp Duties Circular states that all banks are liable to pay stamp duties on specified dutiable transactions relating to loans and credit facilities. These include loan agreement, legal mortgage, bonds (mortgage), tenancy or lease agreement, bank cheque, guarantor’s form, etc., at various specified rates.

We note that some of these rates are inconsistent with the provisions of the SDA. For example, the Stamp Duties Circular provides a flat rate of 6% for all lease agreements, disregarding the varied rates, determined based on the tenure of the lease as provided in the SDA as follows:

- Where the lease tenure does not exceed 7 years (i.e., 1-7 years) - 0.78%
- Where the lease tenure is between 7 and 21 years - 3%
- Where the tenure of the lease exceeds 21 years - 6%

In addition, the rate of ₦1 per cheque leaflet and the duty imposed on guarantor’s form in the Stamp Duties Circular are not in line with the provisions of the SDA. While the SDA provides for a rate of 2 Kobo per cheque leaflet, there is no such instrument as guarantor’s form in the SDA. Therefore, the guarantor’s form should be stamped at a flat rate of 15 Kobo, being a contract not specifically charged with any duty in the SDA (as earlier discussed), instead of ₦500 stated in the Circular.

Therefore, the FIRS needs to review its positions on the application of stamp duties on the above instruments to align with the provisions of the SDA.

4.6 JTB Harmonization Schedule

We are aware that some of the rates adopted by the FIRS emanated from the Joint Tax Board (JTB) Harmonization of Stamp Duty Rates and Items (JTB Harmonisation Schedule), which was created in 2002 and purportedly treated as amending the schedule to the SDA. However, the SDA and the amendments thereto in the Finance Act, remain the subsisting legal framework for the imposition of stamp duties on dutiable instruments in Nigeria.

The SDA contains the framework for the amendment of its provisions under Section 116, where it vests the National Assembly or the House of Assembly of a State with the power to vary the schedule to the SDA. The JTB Harmonisation Schedule is not a legislative instrument and, therefore, cannot amend the SDA. Thus, to the extent that any of the rates in the JTB Harmonisation Schedule contradicts the provisions of the SDA, the Schedule cannot stand, and should be treated as void to the extent of its inconsistency with the SDA. The FIRS should, therefore, follow due process and abide by the due provisions of the SDA. Consequently, it should take steps to amend its position in the areas where the provisions of the Stamp Duties Circular are inconsistent with the enabling SDA.

Please click here to read and download the Stamp Duties Circular.
The Business Reorganisation Circular is aimed at providing guidance on the interpretation of the amendments to the commencement and cessation rules under the CITA, and the business reorganisation rules under CITA, Capital Gains Tax Act, Cap. C1, LFN, 2004 (CGTA) and VAT Act, and practical issues associated with the implementation.

We have provided below, our comments on the salient provisions of the Business Reorganisation Circular.

5.1 Commencement of Trade or Business

The Finance Act has practically resolved the issue of double taxation of profits derived by new companies during their first three years of operations as a result of overlapping basis period, based on the extant tax rules in the CITA. Effectively, affected companies are now required to determine their basis period on preceding year basis (PYB) from their first accounting period.

Notably, the Business Reorganisation Circular provides transition guidelines for companies that are still within their commencement period and whose basis period fall in periods before and after the Finance Act was enacted. However, the Circular was silent about the tax regime that will apply to companies with extant right of election to be assessed to tax on actual year basis (AYB), or that are due to exercise such right, as provided under the old regime, during the transition period. This is particularly so in view of the complexities that would arise due to taxpayers’ different accounting year-ends. Therefore, it is imperative that the FIRS provides clarity on this category of taxpayers.

5.2 Cessation of Business

The Finance Act eliminates the burden placed on companies ceasing business in Nigeria to recompute their tax positions for their penultimate tax year on both the PYB and AYB. Going forward, affected companies will only be required to compute and submit their final tax returns based on the profits derived from the beginning of the final accounting period to the date of cessation, and the tax due (if any) will be payable within six months from the date of cessation of business.

The Business Reorganisation Circular illustrates the determination of the basis period in the year of cessation and circumstances that could result in the filing of two sets of tax returns in a calendar year.

5.3 Business Sold or Transferred

The amendment of Sections 29(9) of CITA, 32 of CGTA and 42 of the VAT Act provides tax reliefs for a trade or business sold or transferred to a Nigerian company for the purpose of better reorganisation. These reliefs are exemption from application of commencement and cessation rules, relief from Capital Gains Tax and VAT on asset transferred. This is to the extent that the transaction occurs between parties who have been related for a minimum of one year.

While the Finance Act provides for withdrawal of the tax concessions where the exempted assets are disposed of within 365 days after the reorganization, the FIRS Circular indicates that penalties and interest shall be charged on the tax due on the withdrawn concessions. In this regard, the FIRS could have made exception for a situation where the disposal of the reorganised assets is outside the control of the disposing entity, and thereby exempt it from penalty and interest.

Please click here to read and download the Business Reorganisation Circular.
6 Tax implications of operation of Real Estate Investment Companies ("REIC") in Nigeria

The REIC Circular is aimed at providing guidance on the interpretation of the amendments to the CITA by the Finance Act in respect of the taxation of REICs in Nigeria. The noteworthy provisions of the REIC Circular are discussed below:

6.1 Introduction of pre-conditions for enjoying EDT exemption

The Finance Act introduced amendments to Section 19 of CITA that exempt distributions made by a REIC to its shareholders from EDT, regardless of whether the distributions are made from current or prior year ‘profits’. Prior to the amendment, the EDT rule had been one of the major impediments to the operationalization of REICs in Nigeria. Therefore, the exemption provided for REICs is a laudable development that could potentially be a game changer in accelerating investments in the real estate industry with the ability to spur growth in the economy.

The REIC Circular has, however, introduced conditions for enjoying the exemption notwithstanding that these conditions are not specified in the Finance Act. These conditions are:

• at least 75% of the rental or dividend income is distributed
• the distribution occurs not later than 12 months after the end of the financial year, in which the rental or dividend income was received by the REIC.

While, on the one hand, a REIC must satisfy these conditions to enjoy a ‘pass through’ status under the CITA, it does not imply that a failure to meet these conditions automatically exposes distributions made by a REIC to its shareholders to EDT. The introduction of such preconditions contradicts the express provisions of the law and the overarching philosophy behind the amendments to Section 19 of the Finance Act – which is to resolve the issue of double taxation of profits.

The FIRS’ view on a REIC’s eligibility to enjoy the EDT exemption may lead to disputes with taxpayers, as taxpayers are reasonably expected to challenge the validity of same.

6.2 Deductibility of expenses incurred by a REIC

The FIRS has clarified that expenses incurred by a REIC for the purpose of earning rental or dividend income due to its shareholders shall not qualify as an allowable deduction in the REIC’s income tax calculations. This position is hinged on the amendments to the CITA that restricts taxpayers from claiming tax deduction for expenses incurred in the generation of tax-exempt profits.

Notwithstanding the seeming technical correctness of this position, the following points should be considered when applying this rule to a REIC:
a) The dividend and rental income earned by a REIC, even though not taxable in its hands is, indeed, taxable in the hands of its beneficiaries. Therefore, it is arguable that the said income does not strictly qualify as tax-exempt. Accordingly, the entitlement to claim valid business expenses should ideally not be forfeited but applied against the rental and dividend income that will ultimately suffer tax. The issue, therefore, is at what level should the expenses be utilized: is it at the REIC level or at the shareholder level, when preparing their tax computations?

b) What is the mechanism for distinguishing between expenses incurred by a REIC for the purpose of earning dividend and rental income due to its shareholders and expenses incurred by the REIC for its own operations? As an example, will a REIC’s staff cost qualify as expenses incurred for the purpose of generating income for its shareholders, or will it qualify as the REIC’s own expense?

It will be useful for the FIRS to provide some guidance on how it intends to administer the expense deductibility rule to a REIC.

6.3 Other Comments

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

The steps taken by the FIRS to release a clarification on the implementation of the tax incentives available to REICs is, therefore, commendable as investors in the real estate sector will need to take advantage of all available incentives to boost and accelerate activities in the sector post-COVID-19.

In this regard, we hope that the FIRS will provide further clarification on the additional points and considerations noted above to enable a seamless implementation by relevant REICs and stakeholders.

Please click [here](link) to read and download the REIC Circular.
Amendment to Section 16 of CITA in relation to Taxation of Insurance Companies

The issuance of the Insurance Taxation Circular is aimed at providing guidance to stakeholders in the insurance industry following amendments introduced by the Finance Act to the following detrimental provisions of Section 16 of the CITA relating to the taxation of insurance businesses:

- restriction of the number of years over which insurance companies can carry forward their tax losses to four years;
- restriction on the tax deductibility of claims and business expenses of general insurance businesses to 25% of their total premium;
- restriction of the amount deductible by general insurance and marine insurance businesses as reserve for unexpired risk to 45% and 25% of total premium, respectively;
- taxation of the whole investment income of life insurance businesses, which includes income relating to insurance policyholders.

The key issues from the CITA Circular are discussed below:

7.1 Non-Life Insurance Business

7.1.1 Reserve for unexpired risk

The Finance Act has expunged the erastwhile provision for the determination of unexpired risk, as itemized above and contained in Section 16(1)(b) of CITA. In its place, the Finance Act prescribes the use of time apportionment of risks accepted during a year of assessment as the basis for determining deductible unexpired risk for a non-life insurance business.

The FIRS illustrates the basis for determining the provision for unexpired risk that is deductible for tax purpose under the Finance Act based on changes in the unexpired risk reserve of an insurance company from one year to the other. In the same vein, the FIRS stipulates that insurance companies shall, henceforth, maintain details and schedule of policies or risks accepted in a given year and the computation of unexpired risks associated with them.

The FIRS’s illustration in the Insurance Taxation Circular appears contradictory to its new requirement for companies to maintain schedules of such risks/policies, as a mere change in unexpired risk from one financial year to another will not reflect the unexpired risk associated with policies or risk accepted by an insurance company in a given year.

Besides the contradiction, the use of changes in unexpired risk creates a challenge in instances where there is a reduction in the unexpired risk position of an insurance company from one financial year to another. The question arising is whether such reduction would be regarded as a writeback of provision for unexpired risk and subjected to tax. Where this happens, the intention of the provisions of the Finance Act on deductibility of provision for unexpired risks would have been undermined.

Thus, in order to avoid ambiguities in the interpretation of this provision, our view is that the FIRS should adopt the sum of estimated provision for unexpired risk associated with all policies or risk accepted in a given year, as the basis for determining the allowable deduction in respect of provision for unexpired risk.

Therefore, insurance companies may proactively include a disclosure in their financial statements to reconcile the changes in unexpired risk reserves for the year with the schedule to be provided to FIRS, for ease of agreement and acceptance by the tax authorities.
7.1.2 Minimum Tax for Non-life Insurance Business

The Finance Act defines the minimum tax applicable to a non-life insurance business as 0.5% of gross premium. The Insurance Taxation Circular defines gross premium for minimum tax computation purposes for non-life insurance business as total of premium received and receivable, i.e., gross premium written (excluding premium returned to the insured).

However, in defining gross premium, the FIRS did not make adjustment for premium relating to risks outside the current financial year or underwritten by other re-insurers. This includes unearned premium, representing the underwriting of risks related to periods other than the current financial year (i.e. prepaid premium). It also includes re-insurance outward, which represents the risks that have been re-insured with another insurer.

Our view is that these items should be excluded in defining gross premium for minimum tax purpose, as they do not constitute income in the current financial year, for an insurance company.

7.2 Life Insurance Business

7.2.1 Minimum Tax for Life Insurance Business

The Insurance Taxation Circular provides that minimum tax for life insurance businesses will be determined as 0.5% of the company’s gross income. The Circular goes further to clarify what constitutes gross income as, “investment income, fees, commission and income from other sources or assets”.

However, we note that the FIRS did not specifically exempt franked investment income (FII) earned on shareholders’ funds from its definition of gross income. We believe that this is an omission by the Insurance Taxation Circular, especially as the Finance Act specifically excludes FII for the purpose of calculating minimum tax for companies other than insurance companies.

Our view is that the FIRS should similarly exempt FII for minimum tax purpose for insurance companies to ensure a level playing field with all businesses governed by the provisions of CITA.

7.2.2 Items considered for Taxation of Life Insurance Business

The Insurance Taxation Circular also prescribes a format for computing the income tax of a life insurance business, based on the amendment introduced by the Finance Act. In the illustrated computation, the FIRS included dividend distribution from actuarial revaluation or any other form of revaluation, as one of the elements of gross income for a life insurance business on which tax should be imposed.

We take note that this is in line with Section 16(3) of the CITA, which provides that any amount distributed in any form as dividend from an actuarial revaluation of unexpired risks or from any other revaluation shall be deemed to be part of the total profits of an insurance company. However, this item was only relevant under the old accounting standard i.e. Statement of Accounting Standard (SAS) where there was a separation between policyholders’ fund and shareholders’ fund.

As the erstwhile SAS has been replaced by International Financial Reporting Standards (IFRS) where distributions from revaluation no longer apply, the inclusion of this item in the tax format of life insurance companies is outdated. Hence, we would advise that subsequent amendments or clarifications should expunge this description to ensure conformance with the IFRS accounting descriptions.

Please click here to read and download the Insurance Taxation Circular.
Conclusion

The issuance of the Circulars by the FIRS to clarify its views on the Finance Act amendments is a step in the right direction. However, the FIRS needs to reassess the issues discussed in this publication and take steps to amend the controversial positions in the areas where the provisions of the Circulars are inconsistent with the enabling legislation.

Meanwhile, taxpayers should be aware that the courts have held that the FIRS’ position in its Circulars does not constitute the law. Therefore, they are at liberty to seek judicial interpretations in areas where they believe that the FIRS’ interpretations are inconsistent with the law.

Please click here to read our e-book on *Finance Act, 2019: Impact Analysis*. 
Appendix


Circular on Tax Implications of the Operation of Regulated Securities Lending Transaction (SEC Lending) in Nigeria

Clarifications on Sundry Provisions of the Finance Act, 2019 as it relates to Companies Income Tax Act

Clarifications on the Provisions of the Stamp Duties Act

Clarification on Commencement and Cessation Rules, and Business Reorganisation: Section 29 of CITA, 32 of CGTA and 42 of VATA (as amended by the Finance Act, 2019)

Circular on Tax Implications of the Operation of Real Estate Investment Companies ("REIC") in Nigeria

Clarification on the Amendment to Section 16 of Companies Income Tax Act (CITA) in Relation to Taxation of Insurance Companies
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