STUDY MANUAL

ADVANCED TAXATION (PEB 2)

ASSOCIATION OF NATIONAL ACCOUNTANTS OF NIGERIA (ANAN)

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MODULE 1

1.00 PURPOSE AND ADMINISTRATION OF TAXES

1.01 Learning outcome

On successful completion of this Module, Students should be able to:

i. Effectively discuss of the origin and essence of income tax in Nigeria;
ii. Examine the sources of tax legislations in Nigeria and their applicability;
iii. Evaluate the process for collection, recovery and payment of taxes;
iv. Deconstruct the process and organs for tax assessment, collection and appeal.

1.02 The Historical Development of Taxes

In pre-colonial Nigeria there are evidences of an elaborate system of taxation and payment of tribute to traditional rulers. For instance in the North, evidence abound of: 1) the existence of the capitation tax on cattle belonging to the Nomads; and 2) community taxes. In the south (Oyo, Egba, Bini and others) there are also evidences of payment of tributes to Obas, Obi's, Igwe etc of taxes ranging between five shillings to ten shillings per head.

In colonial Northern Nigeria the first step to introducing tax was taken in 1904 when Lord Luggard then High Commissioner for Northern Nigeria issued the land Revenue Proclamation No 4 that was meant to secure a proportion of the taxes on land and produce levied by native rulers. Two years later Revenue Proclamation of 1906 No.2 was issued with a view to compounding all forms of taxation that were not authorized by it. It drew a distinction between tributes and other specified traditional taxes; essentially it was a community (or village) tax.
Essentially from 1900 to 1914 the government of colonial Southern Nigeria derived its revenue from duties imposed on imports and exports. The First World War brought about a sharp decline in government revenue, and thus resulted in the introduction of direct taxation, from which government retained half of the tax collected.

In 1927 it was decided that direct taxation should be introduced into Eastern Nigeria, and it should be calculated at $2^1/_2$ percent of "gross total income". In 1928 direct taxes were for the first time collected throughout South-Eastern provinces through Warrant Chiefs. After the Native Revenue Ordinance of 1928 no other legislation was introduced with respect to direct taxation. However, in 1940 the Income Tax Ordinance No. 3 and Direct Taxation Ordinance No. 4 were enacted. The period 1928 – 1940 was devoted essentially to the consolidation of government position throughout the country on matters of taxation and establishment of fiscal system on the division of tax revenue between the multifarious Native Administrations already established and the Central Government.

Direct Taxation ordinance was enacted in 1940. It was enacted as a consolidating. Ordinance of all previous tax ordinances from 1906– 1940. For the first time this ordinance brought the whole of Nigeria under one system of income tax. Section 17 of the ordinance was amended in 1943 requiring all collections to be deposited into the Native Treasury after which the Government share as determined by the Governor should go to the Government Treasury before the residue could be transferred to the revenue of the Native Administration. In 1943 the Income Tax Ordinance was enacted. It was an admixture of poll tax and income tax that was imposed upon the total income or assessable income of natives resident in the township of Lagos and non-natives resident in Nigeria. During this period the Income Tax Ordinance 1943 enable the central government to receive the general revenue of the country whiles the Native Authority of the respective areas and the regional government received revenue accruing from Direct Taxation Ordinance.

In 1954 Nigeria became a federation of three regions, North, East and West. As an autonomous region, the Eastern region passed the Finance law No 1 of 1956 by which people above 16 years were to be assessed to tax. The Western Region followed suit by passing income tax law to replace the Direct Income Tax ordinance in 1957 by which taxable adults could be assessed.

The Nigerian Income tax ordinance of 1943 remained in force in the federal territory of Lagos until 1963 until when the personal income tax (Lagos) 1961 and the Personal Income Tax (Loss Act PIT) 1961 were enacted by the Federal Government.

In 1961 the Federal Government enacted:

i. The Income Tax Management Act 1961;

ii. The Companies Income Tax, 1961; and

iii. The Personal Income Tax Act 1961

Between 1959 and 1961 five tax legislations were enacted in Nigeria based on the recommendation of the Revenue and fiscal commission. These include

i. The Stamp Duties Act (SDA) 1959
ii. The Petroleum Profit Tax Act 1959
iii. The Companies Income Act 1961
iv. The Income Tax Management Act (ITMA), 1961
v. The Personal Income Tax (Lagos) (PITLA), 1961

Between 1961 to date most of the tax legislation have been amended the most recent amendment being the Personal Income Tax Act 2011.

1.03 Tax Legislations

From 1959 to date Nigeria has enacted a host of tax laws. These taxes are imposed either by the national sub national governments. The 1999 constitution of the Federal Republic of Nigeria under the concurrent list in part II of the second schedule item D paragraph 8 provides the national and sub national governments the powers to impose any tax or duty.

Nigerian tax laws are purely statutory. The tax system thus features a wide and mixed range of statutes by which the various governments in the country seek to charge and collect revenue for public expenditure. Of these, the most widely based are on income taxation. The Personal Income Tax Act makes provisions for the country. Liability to personal income tax in Nigeria does not depend on the domicile or nationality of the taxpayer. Profits arising from a trade, business, profession or vocation, from any source inside or outside Nigeria, are chargeable here if the taxpayer happens to be resident in Nigeria. Foreign residents are also taxable here if they have income arising from a Nigerian source. Once a company is incorporated, it becomes a legal entity and is treated under Nigerian law as an artificial person, separate and distinct from its shareholders. Corporate bodies are charged to tax under the Companies Income Tax Act. However, while Nigerian Companies are taxed on their profits, which is attributable to business operations carried on in Nigeria. In addition to the tax income accruing to companies, all incorporated companies are required to pay 2% of their assessable profit into Education Tax Fund. This is charged by virtue of the Education Tax Act.

Where a particular income or profit is chargeable to tax in Nigeria as well as in another country, there is a possibility of the taxpayer getting taxation relief by way of tax credit under the provisions of the income tax statutes. To this end, the Federal Government of Nigeria has negotiated and signed income tax treaties with a few foreign governments. The statues also feature a wide array of tax holidays and exemptions, which are intended to boost investment. For instance, the Industrial Development (Income Tax Relief) Act makes provisions for the grant of tax relief to pioneer companies. The pioneer status is granted mainly to companies in any industry which in the opinion of the National Council of Ministers, is not being carried on in Nigeria on a scale suitable to the economic requirements of the country. Also, a company which has incurred expenditure in its qualifying building and plant equipment in an approved manufacturing activity in an Export Processing Zone is granted 100% capital allowance in any year of assessment. This makes the cost of capital acquisition entirely deductible in the year in which the qualifying expenditure was incurred. Another example is in Part IV of the Minerals and Mining Decree, (now Act) which gives various tax incentives to operators in the solid minerals mining sector.

Exclusively, the Federal Government imposes both personal and company income taxes. The same government also collects company's tax, but it partly delegates the power to collect personal income tax to State governments. In a normal case, personal income tax is thus collected and expended by the state in which the taxpayer is deemed resident in the relevant year of assessment. However, men of the Nigerian armed forces, officers of the foreign-service, persons resident in the Federal Capital Territory and non-residents pay to the Federal government. Nigeria ranks among the major oil producing countries of the world and much of its public revenue is generated from the sale of crude oil and natural gas. All petroleum resources belong to the Federal government, hence, companies engaged in petroleum operations are charged to tax under special legislation, the Petroleum Profits Tax Act (PPTA).

The effect of the Act is however varied by a Memorandum of Understanding (MOU) between the oil producing companies and the Federal Government of Nigeria. Any profit, which is charged to petroleum tax, is exempted from companies' income tax.

Until 1967, there was no tax on capital or capital gains in Nigeria. In that year however, capital gains taxation was introduced. The Capital Gains Tax Act has been retained ever since with only a few amendments. The Act charges to tax any capital gain accruing to individuals and corporate bodies whenever they dispose of assets. The Federal Government has the exclusive authority to tax capital gains but the collection has been partially delegated to States. While corporate bodies pay capital gains tax to the Federal Board of Inland Revenue, others pay to the tax authorities in their States of residence. Inheritance tax, which was levied by virtue of the Capital Transfer Tax Act, was scrapped in 1996.

Before 1993, Nigeria had a limited form of sales tax, but it has since adopted a very widely based Value Added Tax. By virtue of the Value Added Tax Act of 1993, all purchasers of chargeable goods and services are expected to pay 5% of the purchase price as tax. The value Added Tax Act is a federal statute and the tax is administered by the Federal Inland Revenue Service (an arm the Federal Board of Inland Revenue) on behalf of the Federal, State and Local Governments. The proceeds are shared among the three tiers of government in accordance with a formula determined from time to time by the Federal legislature.

Another major source of revenue for the Federal Government is customs duty, which is payable by importers of specified goods. This tax is charged solely by the Federal Government and collected through the Nigeria Customs Service. Excise duty was levied on a variety of locally produced goods until 1988 when the tax was abolished. It was however partially reintroduced, with effect from January 1, 1999. The applicable law for customs and excise is the Customs and Excise Management Act.

The Stamp Duties Act imposes tax on a wide range of documents and transactions. Where one of the parties is a corporate body, the tax is payable to the Federal Board of Inland Revenue. Others pay to the State tax authorities.

Apart from those outlined above, there are sundry levies and rates which local governments are authorized to collect. Notable here is the tenement rate payable annually on buildings situated with a particular local government area. This is levied by virtue of the Tenement Rate Law of the various states. There is also a Development Levy on individuals to State governments. When real property is transferred, the relevant State government imposes some charges before the Governor grants his consent in accordance with the Land Use Act of 1978.

It can be seen from this short survey that the Nigerian tax system features a mixture of direct and indirect taxes. All individuals, groups and corporate bodies that earn income, profits or gains, are affected. Except for tenement rates payable on buildings, there is no tax on the ownership of capital assets per se. capital gains tax is charged only when these assets are disposed of at a profit. Virtually all the major taxes are within the exclusive legislative jurisdiction of the Federal government, but the power to collect is often delegated to the States. The usual pattern is that federal authorities collect taxes from corporate bodies while states are allowed to collect from individuals and unincorporated groups. Even though local government authorities do not have substantive legislative powers, they charge and collect such rates and levies as may be authorized by a statute of the relevant State government.

Under the 1999 Constitution of the Federal Republic of Nigeria, the National Assembly had the power to make laws for the peace, order and good government of the Federation or any part thereof with respect to any matter included in the Exclusive Legislative List. This list contains subjects like corporation, regulation and winding up of corporate bodies and the taxation of incomes, profits and capital gains. The same Constitution further reserves to the federal legislature the power to make laws with respect to any matter in the concurrent list to the extent prescribed in the second column of that list.

Item 7 of that concurrent list is on collection of taxes. The federal legislature is allowed to delegate the collection or administration of some taxes to the Government or other authority of a State, Provided however that taxes on capital gains, incomes or profits of companies cannot be do delegated.

Item 9 of the concurrent list gives state legislatures the power to make provisions for the collection of any tax fee or rate or for the administration of laws providing for such collection by a local government. This clearly justifies the inference that states may impose, collect and spend any tax, fee or rate which has not been expressly reserved for Federal Government control. The assumption is that States could not have been required to delegate to local government councils what they (the States) could not be themselves do. As noted by Bello JSC (as he then was) while reading his lead judgement in Abruagba v. Attorney General (Ogun State). "any tax" as used in the provision empowers the States to impose tax on all matters in the concurrent list and residual matters".

Apart from the income tax which they pay to the Federal Government, companies in Nigeria are subjected to a wide array of taxes, levies and rates by States and Local Government.

Only the Federal government can charge companies to income tax, but other governments can charge companies other taxes within the legislative jurisdiction of those governments. This is, of course, in so far as the tax law does not in effect amount to "regulation" of corporate bodies, which is an exclusive preserve of the federal legislature

It should be noted that, apart from the concurrent powers, the states ordinarily have further jurisdiction over the so called residual matters, i.e., matters which are neither on the exclusive legislative list nor on the concurrent legislative list. Although this was not expressly indicated in the Constitution, the Supreme Court has held in the case of Attorney General (Ogun State) V. Aberuagba that it was the necessary inference to be drawn from section 4(7) of the 1979 Constitution.

There is however one crucial limitation on state legislative powers. In spite of the accommodation allowed the States under the concurrent legislative list, the Constitution further provides that if any law enacted by a State is inconsistent with any law validly made by the Federal Government, the latter shall prevail. The State law shall therefore be void to the extent of the inconsistency. Can this mean that a State cannot collect tax from a person or source of income on which the Federal Government has already imposed a tax? In the course of his judgment in the Aberuagba case, Bello JSC (as he then was) stated that the power of states to impose any tax over concurrent matters can only be exercised "….subject to the rule of inconsistency under Section 5(4) and the doctrine of covering the field." If we accept the applicability of that doctrine, it would mean that whenever the Federal Government enacts a law on an issue on the concurrent list, that enactment forecloses the ability of the States to make a law on the same issue. More particularly it would mean that once the federal government has provided for the collection of taxes from companies.

Since 1959 to date Nigeria has enacted a host of tax laws. Essentially all taxes are imposed either by Federal or State Government. Some of these enactments include:

1.04 Income Tax Management Act 1961

There were various tax systems operating in Northern, Western and Eastern Regions of the country. The inconsistencies and apparent confusion resulted in the setting up of Raisman Fiscal Commission of 1958 who recommended that there should be a uniform basic principle for taxing incomes throughout Nigeria. It was this recommendation that was embodied in the Nigerian (Constitution) Order in Council 1960, which resulted eventually in the enactment of the Income Tax Management Act 1961 (ITMA 1961) ITMA 1961 was the precursor to CITAs 1961, 1979 and 1990 as well as the Personal Income Tax Decree (now Act) of 1993 and 2011

1.05 Income Tax Management (Uniform Taxation Provisions) Decree No. 7, 1975 amendment

In 1975 the Income Tax Management (Uniform Taxation Provisions) Decree No. 7 was promulgated. This Decree unified reliefs and rates throughout the country with the key advantage of resolving, to some extent, the proliferation of various tax laws in the different States of the Federation.

1.06 Finance Miscellaneous (Taxation Provisions) 1985 Decree

There was Finance Miscellaneous (Taxation Provisions) Decree 1985 that introduced some reforms into the tax provisions such as: increase in personal allowances, tax authorities were empowered to request any bank for information about customers (individuals in this case), the basis of computing changed from reducing balance to straight line method, capital allowances claimable was restricted to 75% for manufacturing business and 66 $^2/_3$% for other businesses. No limit for agricultural businesses, capital allowance rates were reviewed upwards and harmonized with that of companies to increase the benefits to tax payers, interest on loan for agricultural and export purposes were to be treated as exempted from tax, (g) losses to be limited to four years for businesses other than agriculture.

1.07 1987 Amendment

The amendment to the Nigerian tax laws in 1987 included:

Slight increase in personal allowances, review, again, of some capital allowances, rates, (c) treatment of withholding taxes on rent, interest, dividends and royalties as “final tax” payable; in other words, they are treated as “franked investment income”.

1.08 1990 Amendment

The following also happened: significant improvement in capital allowances’ rates, (b) removal of limits on capital allowance claimable by manufacturing business.

1.09 1992 Amendment

The amendment includes increase in personal income tax reliefs/allowances, (b) increase in the tax table rates.

1.10 1993 Act

In 1993, the Personal Income Tax Act was promulgated as Decree No. 104 which replaced ITMA 1961 as amended up to the point of abrogation. The Act provides for the taxation of every individual or corporate sole or body of individuals (e.g. partnership) that are deemed to be resident for that year in the relevant State and (ii) increase in the table of rates for the taxation of individuals under PITA.

1.11 1998 Act

Taxes and Levies (Approved List for Collection) Act 1998 authorized Federal Government through Federal Inland Revenue Service to collect personal income tax from:

Members of the Armed Forces of the Federation; members of the Nigeria Police Force; residents of the Federal Capital Territory, Abuja; and Staff of the Ministry of Foreign Affairs and non-resident individuals. Under the same Act, in addition to personal income tax in respect of PAYE, the State Governments are empowered to collect direct taxation (self-assessment).

1.12 Personal Income Tax Amendment Act of 2011

The Personal Income Tax (Amendment) Act, 2011 was made available to the public in January 2012 (although 24 June 2011 was the date of publication stated on the Gazette) .The PITAM amends thirty-six sections of the Personal Income Tax Act, Cap P.8, Laws of the Federation of Nigeria, 2004(PITA).It also modifies the First, Third and Sixth Schedules to the PITA. We have highlighted below the key provisions and implications of the PITAM:

The date of commencement of the amendment is 14th June 2011, based on the Federal Republic of Nigeria Official Gazette No.115, Vol.98. This date is the same as the date of assent of the Act by the President. As a consequence, tax payers and employers may be required to re-compute the personal income tax (PIT)/pay-as-you-earn (PAYE) tax due for the period June2011 to January 2012. We envisage that many tax payers will qualify for refund from relevant tax authorities (RTAs) by reason no for their over payment to tax under the old PIT regime. Given the difficulties currently associated with claiming tax refund in Nigeria, our view is that PIT/PAYE tax over payments would likely be recovered as credit from subsequent remittances to the RTAs.

1.13 PITA Sections 2 and 108: Tax imposition and Interpretation

The main amendment to Section 108 of the PITA is the redefinition of itinerant worker to include “an individual irrespective of his status who works at any time in any stated year of assessment (other than as a member of the armed forces) for wages, salaries or livelihood by working more than one state for a minimum of twenty (20) days in at least three (3) months of every assessment year”. Based on the amendment, employees of service companies who migrate from state to state in providing services to clients may now qualify as itinerant workers.

Similarly, entrepreneurs, company executives and other personnel who by virtue of their responsibilities work in multiple locations in different states may qualify as itinerant workers. The PITAM also amends section2 of the PITA by inserting a new subsection (1A), that provides that “notwithstanding anything in the Principal Act, the relevant tax authority in a State shall have powers to collect tax under this Act from itinerant workers”. Following from the above, individuals who now qualify as itinerant workers may find themselves liable to tax in more than one state. Consequently, such individuals or their employers would need to set up adequate administrative processes to effectively track the duration of stay and income subject to tax in the different states.

1.14 PITA Sections 3: Income chargeable and Personal relief

(a) Tax free allowances are no longer available: Section 3 of the PITA has been amended to highlight the fact that both temporary and permanent employees are liable to PIT. However, the more important implication of the amendment to this section is the effective deletion of section 3(1) (b) (ii)-(xii), which provides employees with tax free allowances such as leave allowance, housing allowance, etc. With the amendment, PITAM has withdrawn all tax free allowances previously enjoyed by employees under the section, with the exception of reimbursement of expenses incurred by an employee in the performance of his duties, and from which the employee is not expected to derive any profit or gain.

1.15 Registration and Collection of Various Taxes, Assessments and Appeals

a. Annual Returns
b. Individuals
c. Identifying Assessable Person

Tax is not imposed in a vacuum; the entity to be taxed and source(s) of the income to be taxed must be identified.

An assessable entity is defined as a person whatever artificial or real who resides in any part of the country in a particular year of assessment with express exemption of religious, charitable, trade union, labor organizations and government boards, states and corporation.

There are personalities relevant to the process of levying and collecting tax. These persons will be taxed under different statutes and in different ways and so it is necessary to identify them.

The first is an individual who is within the taxable age and with income, which may be salary, rent, dividend or interest. He may have shares in companies through which he gets dividend. He may have money lodged in the bank from which he gets interest or he may have properties from which he earns rent.

The second person is the individual who is in business. This is the person that has gone to legalize himself through incorporation. This individual **son** may take two forms. If he decides to start a business on his own with no partners or shareholders, he is said to be a sole proprietor. He bears all the costs and keeps all the profits after the Relevant Tax Authority has taken its cut in taxes, of course. As a sole proprietor, he has unlimited liability. What this means is that he is personally responsible for all the business debts. If he borrowed money for the business and cannot repay the loan, he may be forced into personal bankruptcy.

On the other hand, instead of starting on his own, he may wish to pool his money or expertise with friends or business associates; and another form of individual businessperson known as Partnership has come into being. Usually there is a written partnership agreement, which set out how management decisions are to be made and the rights and duties of partners to the partnership. This includes partners' entitlements like salary, interest on capital and share of profits.

The partners pay personal income tax on their share of profits individually. Partners, like sole proprietors, have the disadvantage of unlimited liability. If the business runs into financial difficulties, each partner has unlimited liability for all the business debts, not just his or her share. However, in practice larger businesses can be set up as limited partnerships, under this, partners are classified as "General" or "Limited".

General partners manage the business and have unlimited personal liability for the business debts. Limited partners usually have a restricted role in management, but their liability is confined to the money they contribute to the business. They can lose everything they put in, but no more.

Many professional businesses are organized as partnerships. They include the large accounting, legal, investment and management consulting firms.

Incomes of individual persons are taxed under Personal Income Tax Act 1993 (as amended by PITA 2011) with certain exemptions.

1.16 Residency Issues in Taxation

After determination of the tax liability of a person, the question of residency becomes very important as this resolves the Relevant Tax Authority to which the tax computed is payable.

Resolving the issue of residency also affect the scope and type of relief and deductions that may be allowed for the purpose of computing taxable income. For example the rent allowance for a person resident in Lagos is different from person resident in Ago-Iwoye.

The Personal Income Tax Act (1993) considered the question of where a person is deemed to be resident in a particular year of assessment along the following lines in its first schedule.

1.17 Persons in Employment on 1st January

The Act deems a person who is in a paid employment or trade at the commencement of a particular year of assessment to be resident for the tax year in a place or principal office (if he resides in more than one place) of residence in that year of assessment. A place of residence means a place available for his domestic use in Nigeria on a relevant day. It does not include any hotel, rest house or other temporary place of abode unless no permanent place is available for his use on that day.

Principal place of residence in relation to an individual with two or more places of residence on a relevant day not been both within any one state means:

(a) For a pensioner, with no other source of income it is that place of those places that he usually residues.

(b) For an individual who has a source of earned income other than a pension in Nigeria, his principal place of residence is that place of those places, within a relevant day is nearest to his usual place of work.

(c) For an individual who has a source or sources of unearned income in Nigeria, the principal place of residence is that place or places in which he usually resides.

1. Persons taking up Employment within the Year

A person taking up an employment/trade during a particular year of assessment is deemed to be resident for that year in a place where he has a place of residence or principal place of residence if he resides in two or more places in an assessment year.

2. Persons on leave from Employment at 1st January

An individual who is on leave from a Nigerian employment on the first day of January in a year of assessment shall be deemed to be resident for that year by reference to his place or principal place of residence immediately before his leaves began.

3. An Individual who is in Foreign Employment on 1st January

An individual who holds a foreign employment on the first day of January or who first becomes liable to tax in Nigeria for that year by reason of his entering that employment during the year and who is not: (a) employed in the Nigeria Army, the Nigerian Navy, the Nigeria Air force, the Nigeria Police Force except in civilian capacity. (b) an officer of the Nigeria Foreign Service (c) resident outside Nigeria and at the same time derives income or profit in Nigeria: shall be deemed to be resident for that year in the territory in which the principal office of his employer is situated on that day or on the day foreign employment commences as may be the case.

Foreign employment means an employment the duties of which are wholly performed outside Nigeria save during any temporary visit of the employee to Nigeria.

4. Armed Forces Personnel

Persons employ in the Armed Forces (in combatant capacities) are deemed to be resident in the Federal Capital Territory for tax purpose in a year of assessment.

5. Pensioners

An individual whose only source of income arising in Nigeria on the first day of January in a year of assessment was a pension and who had a place or principal place of residence shall be deemed to be resident for that year in the territory in which that place or principal place of residence was situated on that day.

6. Trustees, Executors, etc

The tax accruing on the estates managed by trustees and executors on a year of assessment is deemed accrued to the relevant tax authority in charge of a place where the Trustee or Executor has a place or principle or principal place of business (registered office) in the assessment year.

7. Itinerant Worker

In the case of an itinerant worker, tax may be imposed for any year by any state, in which the in itinerant worker is found mostly during the year.

8. Communities

In the case of a village or other indigenous communities, the place of residence is the territory in which the community is to be found in any year of assessment.

Chargeability to Tax

Section 36 of CITA CAP 60 Law of the Federation, 1990 specifically states that a company shall be chargeable to tax:

(a) In its own name; or

(b) In the name of any principal officer, attorney, factor, agent or representative of a company in Nigeria in like manner and to like amounts as such company would be chargeable; or In the name of a receiver or liquidator, or of any attorney, agent or representative thereof in Nigeria, in like manner and to like amount as such company would have been chargeable if no receiver or liquidator has been appointed.

Assessments

The Federal Inland Revenue Service (FIRS) or State Inland Revenue Service (SIRS) is mandated by the various Acts to assess every company or person chargeable to tax as may be after the expiration of the time allowed to such company or person for the filing of return for tax purposes.

Types of Assessment

There are three main types of assessment. These are:

1. Original Assessment
2. Revised or Amended Assessment
3. Additional Assessment
4. Self-Assessment

Original Assessment

This is the first assessment raided on a tax-payer in a particular tax year. However, a taxpayer may not agree with the tax authority on this assessment. The taxpayer can thus, make an objection (by filing a notice of objection).

Revised or Amended Assessment

This is the assessment that is raised to replace an original assessment. This is possible after the notice of objection raised by the taxpayer has been determined.

Additional Assessment

If the tax authority discovers or is of the opinion at any time that any person or company liable to tax has not been assessed or has been assessed at a less amount than that which ought to have been charged, the Board may, within the year of assessment or within six years after the expiration thereof, assess such person or company such amount or additional amount, as ought to have been charged. This type of assessment is known as Additional Assessment.

Forms of Assessment

1. Provisional Assessment. It is an estimate of tax payable based on the tax paid by the taxpayer in the preceding year of assessment.
2. Best of Judgment (BOJ) Assessment. This usually occurs where the taxpayer has either not filed returns or not even registered for tax purposes. The Board will then assess the taxpayer based on their own judgment.
3. Self-Assessment. It was introduced in 1993. The taxpayer is expected to complete a standard Self-Assessment Form. The following are incentives for filing of self-Assessment
   i. Non-payment of provisional tax
   ii. Grant of instalmental payment, provided they accompany attach evidence of payment of first installment in their returns.
   iii. 1% incentive bonus is granted to all self-assessment filers.

Service of Notice of Assessment

The tax authority shall cause to be served on or sent by registered post to a person or each company, or person in whose name a company is chargeable, a notice stating:

(a) The amount of total profits
(b) The tax payable, and
(c) The place at which such payment should be made.

When a taxpayer receives a notice of assessment, he either agrees with it or disagrees. Where he goes, he is required to effect payment of the tax within 60 days from the date of receipt of the assessment. However, where he is aggrieved, there are laid down procedures to be followed for the matter to be resolved.

Corporate Bodies

As the individual or individual business person grow, he or they may become aware of the benefits of another personality very important to the taxman called the company. For Nigeria, a

"Nigerian Company" is defined in section 84 of CITA 1990 supra as, "any company incorporated under the Companies and Allied Matters Act 1990 or any enactment replaced by that Act".

A corporation sole or body of individuals other than a family or community shall be deemed to be resident for a year of assessment in the territory in which its principal office in Nigeria is situated on the first day of January in that year or if it has no office in Nigeria on that day, in a territory in which any part or the whole of its income liable to tax in Nigeria arises for that year.

Any dispute as to the residency of a person in any assessment year shall be referred to the Board for adjudication by the relevant tax authorities involved.

Unlike a proprietorship or partnership, Company is legally distinct from its owner. It has a Constitution or Charter called Memorandum of Association, setting out its powers and status as well as its relationship to the outsiders. The Articles of Association regulate the management of the internal affairs of the company.

Company may be limited by shares or limited by guarantee. The first type is more suitable for commercial purposes. There are two types of companies limited by shares, viz: Private Companies and Public Companies. While a private company is particularly suitable for a small family business, a public company is formed where there is a business requiring large capital, which can only be, raised from the public through stock exchange.

Every company including a company granted exemption from incorporation shall at least once in every year without notice or demand make and deliver to the Board a return together with the following:

i. The audited account, tax and capital allowance computation and a true and correct statement in writing containing the amount of profits from each and every source.
ii. A declaration which shall be signed by a Director or Secretary of the company that the returns contain a true and correct statement of amount of its profit computed in respect of all sources and that the particulars in such returns are true and complete.

Filling of Returns for New Companies

In the case of a newly incorporated company, the submission shall be within eighteen months from the date of its incorporation or not later than six months after the end of its first accounting period, whichever is earlier.

Filing of Returns for Existing Companies

For a company that has been in business for more than eighteen months, not more than six months after the close of the company's accounting year.

Filling of Tax Returns for Self-Assessment Filer

Self-assessment became mandatory for all companies with effect from 1st January, 1998. A tax return for self-assessment tax filer comprises the following:

a. Duly completed self-assessment Income Tax Form (IR3C-4COY);
b. Audited financial statements together with the relevant schedules showing assets, trade debtors, trade creditors etc.;
c. A declaration which shall signed by the Managing Director, a Directors, or Statutory Secretary of the company indicating that the returns contain a true and correct statement of the amount of its profits computed in respect of all sources and that the particulars in such returns are true and complete;
d. Capital allowance computations;
e. Tax computations for the year of assessment;
f. Evidence of direct payment of the whole or part of the tax due into a blank designated for the payment of tax. If there is no default in payment arrangement, the company is granted a bonus of 1% of the tax payable.

Lateness in Filing or Failure to File Self-Assessment Returns

a. A penalty of ₦2, 500 is payable by every company in the first month that failure to file tax returns occurs and thereafter ₦500 penalty attends to each month the failure persists.
b. Denial of installment payment privileges.

c. Forfeiture of 1% bonus for all self-assessment filers.
d. Payment of provisional tax for the year with accrued penalties and interest.
e. Payment of penalty and interest for the period of the default.

Objection to Assessment and Appeal Procedure

Where the taxpayer objects to the assessment made, he is expected to notify the Board in writing to review and revise the assessment. The Notice of Objection should state precisely the grounds of objection and must be made within 30 days from the date of service of notice.

Having examined the books and records together with oral interview the tax authority may revise the assessment and give notice of revision to the company, or the Board may refuse to revise the previous assessments, it can then issue a notice of refusal to amend. If there is no compromise between the parties (Board and the company) the matter goes to the body of appeal commissioners. The taxpayer is expected to file the Notice of Appeal to the Body within 30 days of the receipt of the Notice of Refusal to Amend.

The Notice of Appeal shall specify the following:

(a) Official number of assessment and the tax year
(b) Amount of tax charged by such assessment
(c) Amount of the total profits upon which tax was charged as appeared on the notice of assessment.

1.18 Collection, Recovery and Payment of Tax

Every company shall pay provisional tax of an amount equal to the tax paid by such company in the immediately preceding year of assessment in one lump sum or such number of monthly installments (not being more than six) as may be approved by the Board not later than 3 months from the commencement of each year of assessment.

The tax charged by any assessment which is not or has not been the subject of an objection or appeal by the company shall be payable within 2 months after service of notice upon the company and must not be later than 14th December of the year of assessment in which the tax was charged.

It is however, to be noted that the collection of tax in any case where the company has given notice of an objection or appeal, shall remain in abeyance until such objection or appeal is determined. After the determination of an appeal, the Board shall serve upon the company a notice of the tax payable as so determined and that the tax shall be payable within one month of the date of service of such notice upon the company.

It is pertinent to note that no claim for repayment of tax shall be allowed unless it was made in writing within 6 years after the end of the year of assessment to which it relates. The Board shall give a certificate of the amount of tax to be repaid.

Final and Conclusive Assessments

This occurs where:

(a) No valid objection or appeal has been lodged on assessment raised by the Board within the specified statutory time limit.

(b) No further notice of appeal has been given against the decision of the Body of Appeal Commissioners or the High Court or Court of Appeal.

(c) The amount of total income or profit or tax liability has been determined and agreed by the taxpayer

1.19 Establishment of Tax Appeal Tribunals

1. (1) Pursuant to section 59 (1) of this Act, there shall be established a Tax Appeal Tribunal (hereinafter-referred to as —the tribunal‖) to exercise the jurisdiction, powers and authority conferred on it by or under this Schedule.

(2) The Minister may by notice in the Federal Gazette specify the number of zones, matters and places in relation to which the Tribunal may exercise jurisdiction.

2. Composition of the Tribunal

(1) A Tribunal shall consist of five members (hereinafter referred to as —Tax Appeal Commissioners) to be appointed by the Minister.

(2) A Chairman for each zone shall be a legal practitioner who has been so qualified to practice for a period of not less than 15 years with cognate experience in tax legislation and tax matters.

(3) A Chairman shall preside at every sitting of the Tribunal and in his absence the members shall appoint one of them to be the Chairman.
(4) The quorum at any sitting of the Tribunal shall be three members.

3. Qualifications for appointment as a Tax Appeal Commissioner

A person shall not be qualified for appointment as a Tax Appeal Commissioner unless he is knowledgeable about the laws, regulations, norms, practices and operations of taxation in Nigeria as well as persons that have shown capacity in the management of trade or business or a retired public servant in tax administration.

4. Term of Office

A Tax Appeal Commissioner shall hold office for a term of three years, renewable for another term of three years only and no more, from the date on which he assumes his office or until he attains the age of 70 years whichever is earlier.

5. Resignation and Removal

(1) A Tax Appeal Commissioner may by notice in writing under his hand addressed to the Minister resign his office:

Provided that the Tax Appeal Commissioner shall, unless he is permitted by the Minister to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor assumes his office or until the expiry of his term of office, whichever is earlier.
(2) A Tax Appeal Commissioner may be removed from office by the Minister on the grounds of gross misconduct or incapacity after due inquiry has been made and the Tax Appeal Commissioner concerned has been informed of the reasons for his removal and given an opportunity of being heard in respect of the reasons.

Salary, Allowances and Conditions of Service of Tax Appeal Commissioners

The salary and allowances payable to and the terms and conditions of service of the Tax Appeal Commissioners shall be determined by the Revenue Mobilization Allocation and Fiscal Commission and shall be prescribed in their Letters of Appointment:

Provided that neither the salary and allowances nor the other terms and conditions of service of a Tax Appeal Commissioner shall be varied to his disadvantage after appointment.

Filling Up of Vacancies

7. If for reason other than temporary absence, any vacancy occurs in the office of a Tax Appeal Commissioner, then the Minister shall appoint another person in accordance with the provisions of this Act to fill the vacancy.

Order Constituting a Tribunal to be Final

8. The question as to the validity of the appointment of any person as a Tax Appeal Commissioner shall not be the cause of any litigation in any court or tribunal and no act or proceedings before the Tribunal shall be called into question in any manner on the ground merely of any defect in the constitution of the Tribunal.

9. Secretary to the Tribunal

(1) The Minister shall appoint for each place or zone where the Tribunal is to exercise jurisdiction a Secretary who shall-

(a) Subject to the general control of the Tax Appeal Commissioners, be responsible for keeping records of the proceedings of the Tribunal;

(b) Be the head of the secretariat and responsible for-

i. The day-to-day administration; and
ii. The direction and control of all other employees of the Tribunal

(2) The official address of the Secretary appointed for each zone shall be published in the Federal Gazette.

Other Staff of the Tribunal, etc.

(1) The Minister shall appoint such other employees as he may deem necessary for the efficient performance of the functions of the Tribunal and the remuneration of persons so employed shall be determined by the National Salaries and Wages Commission.

(2) It is declared that employment in the Tribunal shall be subject to the provisions of the Pension Reform Act and, accordingly, officers and employees of the Service shall be entitled to pensions and other retirement benefits as are prescribed under the Pension Reform Act.

Jurisdiction of the Tribunal, etc.

(1) The Tribunal shall have power to adjudicate on disputes, and controversies arising from the following tax laws (hereinafter referred to as —the tax laws‖)-

i. Companies Income Tax Act, CAP. 60 LFN; 1990

ii. Personal Income Tax Act No. 104, 1993

iii. Petroleum Profits Tax Act CAP. 354 LFN; 1990

iv. Value Added Tax Act No. 102; 1993

v. Capital Gains Tax Act CAP. 42 LFN; 1990, and

vi. Any other law contained in or specified in the First Schedule to this Act or other laws made or to be made from time to time by the National Assembly.

(2) The Tribunal shall apply such provisions of the tax laws referred to in subparagraph (1) of this paragraph as may be applicable in the determination or resolution of any dispute or controversy before it.

Criminal Prosecution
Where in the course of its adjudication, the Tribunal discovers evidence of possible criminality; the Tribunal shall be obliged to pass such information to the appropriate criminal prosecuting authorities, such as the office of the Attorney-General of the Federation or the Attorney General of any state of the Federation or any relevant law enforcement agency.

Appeals from Decisions of the Service 249

(1) A person aggrieved by an assessment or demand notice made upon him by the Service or aggrieved by any action or decision of the Service under the provisions of the tax laws referred to in paragraph 11, may appeal against such decision or assessment or demand notice within the period stipulated under this Schedule to the Tribunal.

(2) An appeal under this schedule shall be filed within a period of 30 days from the date on which a copy of the order or decision which is being appealed against is made, or deemed to have been made by the Service and it shall be in such form and be accompanied by such fee as may be prescribed provided that the Tribunal may entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for the delay.

(3) Where a notice of appeal is not given by the appellant as required under subparagraph (1) of this paragraph within the period specified, the assessment or demand notices

shall become final and conclusive and the Service may charge interests and penalties in addition to recovering the outstanding tax liabilities which remain unpaid from any person through proceedings at the Tribunal.

Appeals by the Service

Service aggrieved by the non-compliance by a person in respect of any provision of the tax laws; it may appeal to the Tribunal where the person is resident giving notice in writing through the Secretary to the appropriate zone of the Tribunal.

Procedure before Tax Appeal Tribunal

(1) As often as may be necessary, Tax Appeal Commissioners shall meet to hear appeals in the jurisdiction or zone assigned to that Tribunal.

(2) Where a Tax Appeal Commissioner has a direct or indirect financial interest in any appeal pending before the Tribunal or where the taxpayer is or was a client of that Tax Appeal Commissioner in his professional capacity, he shall declare such interest to the other Tax Appeal Commissioners and refrain from sitting in any meeting for the hearing of that appeal.

(3) The Secretary to the Tribunal shall give seven clear days' notice to the Service and to the appellant of the date and place fixed for the hearing of each Appeal except in respect of any adjourned hearing for which the Tax Appeal Commissioners have fixed a date at their previous hearing.

(4) All notices, documents, other than decisions of the Tribunal, may be signified under the hand of the Secretary.

(5) All appeals before the Tax Appeal Commissioners shall be held in public.

(6) The onus of proving that the assessment complained of is excessive shall be on the appellant.

(7) At the hearing of any appeal if the representative of the Service proves to the satisfaction of the Tribunal hearing the appeal in the first instance that-

(a) the appellant has for the year of assessment concerned, failed to prepare and deliver to the Service returns required to be furnished under the relevant provisions of the tax laws mentioned in paragraph 11;

(b) The appeal is frivolous or vexatious or is an abuse of the appeal process; or

(c) It is expedient to require the appellant to pay an amount as security for prosecuting the appeal, the Tribunal may adjourn the hearing of the appeal to any subsequent day and order the appellant to deposit with the Service, before the day of the adjourned hearing, an amount, on account of the tax charged by the assessment under appeal, equal to the tax charged upon the appellant for the preceding year of assessment or one half of the tax charged by the assessment under appeal, whichever is the lesser plus a sum equal to ten percent of the said deposit, and if the appellant fails to comply with the order, the assessment against which he has appealed shall be confirmed and the appellant shall have no further right of appeal with respect to that assessment.

(8) The Tribunal may, after giving the parties an opportunity of being heard, confirm, reduce, increase or annul the assessment or make any such order as it deems fit.

(9) Every decision of the Tribunal shall be recorded in writing by the Chairman and subject to the provisions of paragraph 16, a certified copy of such decision shall be supplied to the appellant or the Service by the Secretary, upon a request made within 30 days of such decision.

(10) Where upon the hearing of an appeal-

(a) No accounts, books or records relating to profits were produced by or on behalf of the appellant;
(b) such accounts, books or records were so produced but rejected by the Tribunal on the ground that it had been shown to its satisfaction that they were incomplete or unsatisfactory;

(c) the appellant or his representative, at the hearing of the appeal, has neglected or refused to comply with a notice delivered or sent to him by the Secretary to the Tribunal, without showing any reasonable cause; or

(d) the appellant or any person employed, whether confidentially or otherwise, by the appellant or his agent (other than his legal practitioner or accountant acting for him in connection with his ability to tax) has refused to answer any question put to him by the Tribunal, without showing any reasonable cause the Chairman of the Tribunal shall record particulars of the same in his written decision.

Procedure following decision of the Tribunal

(1) Notice of the amount of the tax chargeable under the assessment as determined by the Tribunal shall be served by the Service upon the taxpayer or upon the person in whose name such taxpayer is chargeable.

(2) An award or judgment of the Tribunal shall be enforced as if it were a judgment of the Federal High Court upon registration of a copy of such award or judgment with the Chief Registrar of the Federal High Court by the party seeking to enforce the award or judgment.

(3) Notwithstanding that an appeal is pending, tax shall be paid in accordance with the decision of the Tribunal within one month of notification of the amount of the tax payable in pursuance of subparagraph (1) of this paragraph.

Appeal to the Federal High Court

17.

(1) Any person dissatisfied with a decision of the Tribunal constituted under this Schedule may appeal against such decision on a point of law to the Federal High Court upon giving notice in writing to the Secretary to the Tribunal within 30 days after the date on which such decision was given.

(2) A notice of appeal filed pursuant to subparagraph (1) of this paragraph shall set out all the grounds of law on which the appellant's case is based.

(3) If the Service is dissatisfied with the decision of the Tribunal, it may appeal against such decision to the Federal High Court on points of law by giving notice in writing as specified in subsection (1) of this section to the Secretary within 30 days after the date on which such decision was given.

(4) Upon receipt of a notice of appeal under subparagraph (1) or (2) of this paragraph, the Secretary to the Tribunal shall cause the notice to be given to the Chief Registrar of the Federal High Court along with all the exhibits tendered at the hearing before the Tribunal.

(5) The Chief Judge of the Federal High Court may make rules providing for the procedure in respect of appeals made under this Act and until such rules are made, the Federal High Court rules relating to hearing of appeals shall apply to the hearing of an appeal under this Act.

Right to Legal Representation

(1) A complainant or appellant, as the case may be, may either appear in person or authorize one or more legal practitioners or any of its officers to represent him or its case before the Tribunal.

(2) Every individual or company in a case before the Tribunal shall be entitled to be represented at the hearing of an appeal by a solicitor or chartered accountant or adviser provided that, if the person appointed by the taxpayer to be representative in any matter before the Tribunal is unable for good cause to attend hearing thereof, the Tribunal may adjourn the hearing for such reasonable time as it deems fit, or admit the appeal to be made by some other person or by way of a written address.

Application of Statute of Limitation

The provisions of any statute of limitation shall not apply to any appeal brought before the Tribunal.

Powers and procedures of the Tribunal

(1) The Tribunal may make rules regulating its procedures.

(2) The Tribunal shall, for the purposes of discharging its functions under this Schedule, have power to:

i. Summon and enforce the attendance of any person and examine him on oath;

ii. Require the discovery and production of documents;

iii. Receive evidence on affidavits;

iv. Call for the examination of witnesses or documents;

v. Review its decisions;

vi. Dismiss an application for default or deciding matters exparte;

vii. Set aside any order or dismissal of any application for default or any order passed by it exparte; and

viii. Do anything which in the opinion of the Tribunal is incidental or ancillary to its functions under this Schedule.

(3) Any proceeding before the Tribunal shall be deemed to be a judicial proceeding and the Tribunal shall be deemed to be a civil court for all purposes.

Minister to make Rules and Regulations

21. The Minister may make rules prescribing the procedure to be followed in the conduct of appeals before the Tribunal.

Costs

22. Each party to an appeal shall bear its own cost.

Further Appeals

23. An appeal against the decision of the Federal High Court at the instance of either party shall lie to the Court of Appeal.

(1) A Tax Appeal Tribunal is established, as provided for in the fifth Schedule to this Act.

(2) The Tribunal shall have power to settle disputes arising from the operations of this Act and under the First Schedule.

Relevant Tax Authorities

There are three (3) tax authorities representing the 3 tiers of government:

- Federal Government (FIRS) - Federal Inland Revenue Service
- State Government (SIRS) - State Internal Revenue Service
- Local Government - Revenue Committee

Federal Inland Revenue Service (FIRS)

Federal Inland Revenue Service (FIRS) is the federal tax authority and was created by the Companies Income Tax Act (CITA) of 1979 and now under the FIRS Establishment Act, 2007. The Board responsible for its management is Federal Inland Revenue Service Board (FIRSB).

Composition of the Board (FIRSB)

The Act stipulates the membership of the FIRSB as follows:

(1) There is established for the Service a board to be known as the Federal Inland Revenue Service Board which shall have overall supervision of the Service as specified under this Act.

(2) The Board shall consist of:

(a) The Executive Chairman of the Service who shall be experienced in taxation as Chairman to be appointed by the President and subject to the confirmation of the Senate;

(b) Six members with relevant qualifications and expertise who shall be appointed by the President to represent each of the six-geo-political zones;

(c) A representative of the Attorney-General of the Federation;

(d) The Governor of the Central Bank of Nigeria or his representative;

(e) A representative of the Minister of Finance not below the rank of a Director;

(f) The Chairman of the Revenue Mobilisation, allocation and Fiscal Commission or his representative who shall be any of the commissioners representing the 36 states of the Federation;

(g) The Group Managing Director of the Nigerian National Petroleum Corporation or his representative who shall not be below the rank of a Group Executive Director of the Corporation or its equivalent;

(h) The Comptroller-General of the Nigerian Customs Service or his representative not below the rank of Deputy Comptroller-General.

(i) The Registrar-General of the Corporate Affairs Commission or his representative not below the rank of a Director; and

(j) The Chief Executive Officer of the National Planning Commission or his representative not below the rank of a Director;

(3) The members of the Board, other than the Executive Chairman, shall be part-time members.

Powers and Duties of the FIRSB

FIRSB has the powers to assess and collect taxes on behalf of Federal Government.

The Board shall

(a) Provide the general guidelines relating to the functions of the Service;

(b) Manage and superintend the policies of the Service on matters relating to the administration of the revenue, assessment, collection and accounting system under this Act or any enactment or law;

(c) Review and approve the strategic plans of the Service;

(d) Employ and determine the terms and conditions of service including disciplinary measures of the employees of the Service;

(e) Stipulate remuneration, allowances, benefits and pension of staff and employees in consultation with the National Salaries, Income and Wages Commission; and

(f) Do such other things in its opinion that are necessary to ensure the efficient performance of the functions of the Service under this Act.

Technical Committee of the Board

This is also a creation of the Companies Income Tax Act, 1979 as amended. It has the following as members:

i. Executive chairman as who is also the chairman the service
ii. All directors and heads of department of the Federal Inland Revenue Service
iii. The legal adviser to the Board
iv. The Board Secretary.

The committee has power to co-opt additional member(s) as may be required in the discharge of its duties. It has the following functions to carry out:

(i) To consider tax matters requiring professional and technical expertise and make recommendations to the Board.
(ii) To advise the board on its powers and duties.
(iii) To carry out any other duty assigned to it by the Board.

The State Internal Revenue Service Board

The State Internal Revenue Service was established by the Personal Income Tax Decree of 1993 as the state tax authority. The operational arm of the board is the State Internal Revenue Service Board. The PITD (1993) Section 85A (1) provides a uniform composition for the boards in all the states of the federation.

The composition is as follows:

(a) The executive head of internal revenue service who shall be designated as the chairman of the Board. He shall be a person experience in tax matters and be appointed by the State government from within the State service.

(b) Three person nominated by the commissioner of finance of the State on their personal merits.
(c) All the directors and head of the State Internal Revenue Service.
(d) A director from the State Ministry of Finance.
(e) The legal adviser to the Board.
(f) The secretary to the Board who shall be an ex-officio member appointed by the Board from within SIRSB.

Functions of the Board (SIRSB)

(a) Ensuring the effectiveness and optimum collection of all taxes and penalties due to the government under the relevant laws.
(b) Doing all such things that may be deemed necessary and expedient for the assessment and collection of the tax and shall account for all amounts so collected in a manner to be prescribed by the commissioner.
(c) Making recommendations, where appropriate to the Joint Tax Board on tax policies, tax reforms, tax legislation, tax treaties and exemption as may be required from time to time.
(d) Generally controlling the management of the service on matters of policy subject to the provisions of the law setting up the service.
(e) Appointing, promoting, transferring and imposing discipline on employees of the State service.

Technical Committee of the SIRSB

The technical committee of the Board of the State Internal Revenue was also established by the Personal Income Tax Decree (1993). It comprises of the following as members.

(i) The chairman of the State Board of Internal Revenue who is also the chairman of the technical committee.
(ii) All the directors of the State Internal Revenue Service.

(iii) The legal adviser to the State Board.

(iv) The secretary to the technical committee.

Functions of the State Technical Committee of SIRS

To advice the State Board on matters that require professional and technical expertise.

To carry out any other duty assigned to it by the State Board.

Joint Tax Board (JTB)

The Joint Tax Board was established, by Section 85 of PIT as amended. Its function includes among other things, mediation between tax authorities of the States and Federation in case of tax disputes. The compositions of the Board as provided by the Personal Income Tax Decree of 1993 are as follows:

i. The Chairman of the Federal Inland Revenue Service who is also the Chairman of the Joint Tax Board

ii. One member from each State of the federation, being a person experienced in tax matters nominated by the Commissioner of Finance

iii. The secretary to the board who shall be an officer experienced in tax matters, appointed by the federal civil service commissioner, though not a member, but he is responsible for keeping records of the board's proceedings and performing other administrative duties; and

iv. The legal adviser of the Federal Inland Revenue Service Board is to be in attendance at the board's meeting and is to be the legal adviser to the board.

The Power and Duties of the Joint Tax Board

The Personal Income Tax Decree of 1993 stipulates the powers and duties of the Joint Tax Board as follows:

i. To exercise the powers or duties conferred on it by express provision of this decree, and any other powers, and duties arising under this decree which may be agreed by the government of each territory to be exercised by the board.
ii. To exercise powers and perform duties conferred on it by any enactment of the Federal Government imposing tax on the income and profit of companies or which may be agreed by the minister or to be exercised or performed by it under the enactment in place of the Federal Inland Revenue Service Board.
iii. To advice the federal government, requests, in respect of double taxation arrangement concluded or under consideration with any other country, and in respect of rates of capital allowances and other taxation matters having effect throughout Nigeria and in respect of any proposed amendment to this decree.
iv. To use its best endeavours to promote uniformity both in the application of tax laws and in the incidence of tax on individuals throughout Nigeria.
v. Impose its decision on matters of procedure and interpretation of this decree on any state for purpose of conforming to agreed procedure or interpretation.
vi. Processing for approval, decisions on provident funds schemes which are to be recognized as tax allowance for deductions.
vii. Resolving any dispute in determination of residence between taxpayers and a tax authority.
viii. To exercise any other powers or duties arising under the decree that may be agreed to by government of each State.
ix. From the above powers and duties, it could be seen that the JTB harmonizes tax administration in the country.

State Joint Revenue Committee

This is established for each State of the federation. It shall comprise:

(a) The chairman of the State Internal Revenue Service as the chairman
(b) The chairman of the Local Government Revenue Committees.

(c) A representative of the Bureau on Local Government Affairs not below the rank of a director.

(d) A representative of the Revenue Mobilization Allocation and Fiscal Commission, as an observer.

(e) The State Sector Commander of the Federal Road Safety Commission, as an observer.

(f) The legal adviser of the State Internal Revenue Service.

(g) The secretary of the committee who shall be a staff of the State Internal Revenue Service.

Functions of the State Joint Revenue Committee

(i) Implementing decisions of the Joint Tax Board.

(ii) To advice the Joint Tax Board and the State and Local Government on revenue matters.

(iii) Harmonize tax administration in the state.

(iv) Enlighten members of the public generally on State and Local government revenue matters.

(v) Carry out such other functions as may be assigned to it by the Joint Tax Board.

The Local Government Revenue Committee

The local government revenue committee is the local government tax authority. The committee was established by the provision of Section 85 of Personal Income Tax Decree of 1993. The committee is empowered to collect taxes at the local government level. The taxes to be collected by the local government revenue committee are listed in appendix one of the decree. The compositions of the governing body of the revenue committee are as follows:

(i) The chairman who is the supervisor of finance.

(ii) Three local government councillors.

(iii) Two persons to be nominated by the chairman of the local government. Those to be nominated must be experienced in revenue matters.

Functions of the Revenue Committee

(i) It shall be responsible for the assessment and allocation of all taxes, fines and rates under its jurisdiction and shall account for all amounts so collected in a manner to be prescribed by the chairman of the local government.

(ii) It shall be autonomous of the local government treasury and be responsible for the day to day administration of the department, which form its operational arm.

(iii) Advice the local government on tax related matters.

1.20 Review Questions

1. When can an assessment be said to be final and conclusive?

Solution

An Assessment Becomes Final and Conclusive

(i) When no valid objection has been lodged within time limit stated in the notice of assessment.

(ii) Where a tax payer and the Board have agreed as to the amount of tax liability of the tax payer after a valid objection has been made.

(iii) Where no valid appeal has been lodged against decision of the Tax Appeal Tribunals or a judge.

2. An aggrieved taxable person may appeal against an excessive assessment to a relevant tax authority:

   (i) What is the time limit allowed for such appeal?

   (ii) State six contents of such notice of appeal.

Solution

(i) An aggrieved person may appeal against the assessment on giving notice within thirty days after the date of service of notice of the refusal of the relevant tax authority to amend the assessment as desired.

(ii) The contents of notice of appeal to be given to relevant tax authority in writing are:

   (a) The name and address of the applicant.

(b) The official number and the date of the relevant notice of assessment.
(c) The amount of the assessable, total or chargeable income and of the tax charged as shown by that notice and the year of assessment concerned.
(d) The precise grounds of appeal against the assessment.
(e) The address for service of any notice of other documents to be given to the applicant.
(f) The date on which the applicant was served with notice of refusal by the relevant tax authority to amend the assessment as desired.

3.
(a) State the benefits of the Self-Assessment System.
(b) Write short notes on:
  (i) Final and conclusive Assessment.
  (ii) Best of Judgment Assessment.
  (iii) Time limit for paying tax.

Solution

(a) Benefits of the Self-Assessment System

These include:

- Returns can be filed by new corporate entities not later than 18 months from the date of commencement or six months after the company's financial year;
- Tax collection costs would be reduced;
- Concession may be granted on application for the tax liability to be paid instalmentally;
- Exemption from payment of provisional tax;
- It accelerates the pace of tax collection with the attendant cash flow benefits to government; and
- The long time-lag between the submission of returns and the service of the notices of assessment would be eliminated.

(b) (i) **Final and Conclusive Assessment**

An assessment raised on a company is said to be final and conclusive where:

- No valid objection or appeal has been lodged against the amount of total profits assessed on a company within the time statutorily allowed for that purpose, or
- The amount of total profits has been agreed by the tax payer after his objection has been determined by Federal Inland Revenue Service or State Internal Revenue Service; or

- The amount of total profits has been determined on appeal.

(ii) **Best of Judgment Assessment**

The Federal Inland Revenue Service will assess a company to tax based on its "Best of Judgment" under the following situations:

- Where a company files its returns, audited accounts and tax computations, the tax authority may refuse to accept same if found unsatisfactory and therefore proceed to determine, based on its 'Best of Judgment', the company's total profits and raise an assessment accordingly;
- Where a company has failed to submit self-assessment returns, audited accounts, etc.; and the Federal Inland Revenue Service is of the opinion that it is liable to tax, it may proceed, based on its 'Best of Judgement' to determine the total profits of such a company and raise an assessment accordingly.

(iii) **Time Limit for Paying Tax**

The time limit for the payment of income tax depends on whether or not the tax payable has been determined by;

- an assessment raised by the Federal Inland Revenue Service on a company or the relevant tax authority in respect of individuals,
- Self-assessment filed by the company.

MODULE 2

2.00 GENERAL PRINCIPLES OF TAXATION

2.01 Learning Outcome

On successful completion of this Module, Students should be able to:

i. Appraise the meaning, types and the purpose of capital allowances and be able to apply these to various qualifying capital expenditure;
ii. Determine and compute basis period and loss reliefs;
iii. Examine the basic principles for balancing charge and balancing allowance;
iv. Analyze the basis for dealing with changes in accounting date;
v. Prepare Capital allowances computations in accordance with the applicable provisions of CITA/PITA.

2.02 Basis Period

Introduction

The principle guiding the determination of basis period of assessable profits for companies and assessable income for individual business person is the same. Basis period of assessment is the period, the profit of which is to be assessed in a year of assessment. It is the period of business activity to be taken into account in determining the tax liability of a chargeable person in a particular year of assessment.

Importance of Correct Determination of Basis Period

The importance of correct determination of basis period cannot be over emphasized because of the following reasons:

(a) It aids the tax authority in making an all-inclusive assessment of tax payers' profits whereby a profit is not taxed twice while no portion of taxable profit is left unassessed.

(b) It helps in the determination of the appropriate grant of capital allowances as well as the carry forward of such capital allowances.

(c) In computation of loss relief, the correct identification of basis periods helps in determining the set off as well as lapsing of losses.

Normal Basis Period of Assessment

A preceding year basis is mostly applicable where the basis period is normal. That is, the profit that will be taxed in this year of assessment is the profit of the previous year.

The following features characterize normal basis period:

(a) It must be of 12 months duration.

(b) It must be the only accounting period ending in a preceding fiscal or tax year.

(c) It must also be commenced from a day immediately after the end of the previous year that is, there is an element of continuity. There must be no gap or coincidence of dates; one basis period must commence the day after the end of the previous one.

These conditions will apply to a person in continuous business.

At this juncture we must clearly define certain terms used in defining normal basis period.

The terms are:

Accounting Year or Accounting Period, Fiscal or Tax Year

Accounting Year: Accounting year is the period chosen and consistently followed by a business to report on its financial situation. This is done through preparation of financial statements covering the accounting year, which is usually twelve months. To avoid complications it is advisable that a company choose an accounting year that tally with that of government fiscal year. However, an individual businessperson is free to choose its accounting year.

Fiscal Year: This is the government accounting year. In Nigeria it presently runs from January – December. It is also called tax year or year of assessment. The federal government changed its fiscal year end from 31st March to 31st December with effect from 1980.

Abnormal Basis Period

The following are examples of situations where normal basis period will not apply:

(a) Where a business has just commenced operation

(b) Where a business has ceased operation

(c) Where there is a change in accounting date

Basis Period of a Company Just Commencing Business

There are commencement rules guiding assessment of a company that is starting business newly. The normal basis period cannot apply because there will be no profits of preceding accounting period from which assessment can derive.

In the ascertaining the assessable profit for any person commencing trade or business newly, three years account must be submitted.

The first of which must be an account made up from the date of commencement of trade or business to the end of the fiscal year.

The second of which must be a 12 months profit made up from the date of commencement.

For the third year, the assessable profits shall be the profit of the company for the accounting year ending in the preceding year of assessment, that is, normal basis period. However in the third year of assessment, if the accounting period that ended in the preceding year is less than 12 months, the Board will exercise discretion in adoption one of the following three methods in arriving at the assessable profits.

(i) Adopt the profits of the second year, which is of 12 months duration

(ii) Adopt the 12 months that ended in the preceding 31st December.

(iii) Use the profits of the first year but grossed up to 12 months.

In this book we adopted the first method; which is also the method commonly preferred in professional examinations. However in practice the Board may want to select the one that result in the highest assessable profit.

Illustration

A company commenced business from 1st August 2002 and prepared accounts to 31st March 2003 and thereafter decide to retain 31st March as its accounting year-end. Determine the basis period for the relevant tax years.

Tax Year	**Basis Period of Assessment**
2002	1.8.02 – 31.12.02
2003	1.8.02 – 31.7.03
2004	1.8.02 – 31.7.03*
2005 (PYB 2004)	1.4.03 – 31.3.04

*In the 3rd year of assessment and in a case of company making up its account to any period before the commencement period or any month before the commencement month. It is not likely to get a normal 12 month basis period ending in the preceding tax year and as such the same basis period as in the second year is used.

A/c made up to – 31/3

Commencement – 1/8

March is before August

Since the company commenced business in August 02, it could not, therefore, have profit to be assessed for January, February, March, April, May, June, July.

Another situation where preceding year basis will not operate is where the first account prepared for a period is in excess of 12 months. You will use again the basis period of the 2nd year of assessment for the 3rd year of assessment.

Illustration 2

The recent financial results of a company adjusted for tax purposes are as follows:

	N
8 months to 31st March, 2002	130,000
Year to 31st March, 2003	150,000
Year to 31st March, 2004	160,000
Year to 31st March, 2005	180,000

You are required to determine the relevant basis periods for assessment and the assessable profits.

Tax Year	Basis Period of Assessment		Assessable Profit
			N
2001 1st Year	1.8.01 – 31.12.01 5/8 x 130,000	=	81,250
2002 2nd Year	1.8.01 – 31.7.01 8/8 x 130,000 +		
	4/12 x 150,000	=	180,000

2003 3rd Year	1.8.01 – 31.7.02 8/8 x 130,000 +			
		5/12 x 150,000	=	180,000
				441,250
2004 4th Year (PVB) 1.4.02 – 31.3.2003				150,000
2005 5th Year (PVB) 1.4.03 – 31.3.2004				160,000

Accounting year and applicable profits

1.8.01 – 31.3.02,	N130,000 (8 months)
1.4.02 – 31.3.03,	N150,000 (12 months)
1.4.03 – 31.3.04,	N160,000 (12 months)
1.4.04 – 31.3.05,	N180,000 (12 months)

Illustration

Let us consider an example where the first account was made up to a period that is more than 12 months.

A company adjusted for tax profits are as follows:		N
20 months to	31.5.02	600,000
Year to	31.5.03	800,000
Year to	31.5.04	900,000
Year to	31.5.05	1,000,000

Calculate the basis period of assessment and the assessable profit for the first five tax years.

Basis Period of Assessment		**Assessable Profit**	N
Tax Year 00	1.10.00 – 31.12.00	3/20 x 600,000 =	150,000
Tax Year 01	1.10.00 – 30.9.01	12/20 x 600,000 =	360,000
Tax Year 02	1.10.00 – 30.9.01	12/20 x 600,000 =	360,000
			870,000

Tax Year 03 (PYB 02) 1.6.01 – 31.5.02	12/20 x 600,000 =	360,000
Tax Year 04 (PYB 03) 1.6.02 – 31.5.03		800,000

Illustration 4

We shall now consider where a company accounting year-end is after commencement month.

A company makes up its account to 31st October each year; the results for the following years are as follows:

	N	
3 months to 31.10.01	300,000	1.8.01 – 31.10.01
Year to 31.10.02	450,000	1.11.01 – 31.10.02
Year to 31.10.03	600,000	1.11.02 – 31.10.03
Year to 31.10.04	800,000	1.11.03 – 31.10.04

You are required to determine the basis period and assessable profit for the 3 years of assessment.

Tax Year	**Basis Period of**	**Assessable Profit**	N
2001	1.8.01 – 31.12.01	300,000 + 2/12 x 450,000 =	375,000
2002	1.8.01 – 31.7.02	300,000 + 9/12 x 450,000 =	637,500
2003 (PYB 2002)	1.11.01 – 31.10.02	=	450,000

Please note that PYB operates easily for the third year of assessment since the company makes up its account to 31st October, which is after the commencing month of August.

Illustration

Where the first account made up is for some period more than 12 months, even if, the company accounting year-end is after the commencement month; the rule that the result of the second year of assessment will be used for the 3rd year of assessment will apply.

We shall use the immediate example in illustration to illustrate this point but with the assumption that the first account was made up to 15 months.

	N
15 months to 31.10.2001	300,000

Year to	31.10.2002	450,000
Year to	31.10.2003	600,000
Year to	31.10.2004	800,000

You are required to determine the basis period and the assessable profit for the first four years of assessment.

Tax Year	**Basis Period of**		**Assessable Profit**
2000	1.8.00 – 31.12.00	5/15 x 300,000 =	100,000
2001	1.8.00 – 31.7.01	12/15 x 300,000 =	240,000
2002	1.8.00 – 31.7.01	12/15 x 300,000 =	240,000
			580,000
2003 (PYB 2002)	1.11.01 – 31.10.02	=	450,000

Change of Accounting Date

When there is a change of accounting date the Revenue has power to compute as it deems fit the assessable profits for:

(i) The year of assessment in which the change occur; and

(ii) two years of assessment following the year of change.

The assessable profits will be computed on the basis of the old and the new accounting dates for the three relevant years and the Revenue will decide on the alternative that produces higher assessable profits. Note that the preceding year rule is strictly observed throughout the computations.

Illustration

Format Construction Nigeria Ltd., is an incorporated company in Nigeria with affiliates worldwide. It has been operating in Nigeria for many years and prepares its accounts to 31 December of every year. The controlling company for all the affiliates worldwide which has its registered office in Sweden had also been preparing its accounts to 31 December of every year, until 1993. When it decided at its board meeting that all affiliated companies worldwide must submit copies of their 12 months audited accounts two months before 31 December of every year, beginning from 1993.

There are two alternatives the Board of Directors of Format Construction Nigeria Ltd. is considering:

To prepare accounts for the year ending within 1994, to end in:

a) June, 1994 or

b) September 1994

As a Tax Consultant, your advice is sought, so as to ascertain the financial year-end that would minimize the assessable profits on which tax is payable for those periods. The following information was provides:

	N
Net Profit per accounts for 12 months ended 31 Dec. 1992	200,000
Net Profit per accounts for 12 months ended 31 Dec. 1993	500,000
Net Profit per accounts for 12 months ended 31 Dec. 1994	600,000
Net Profit per accounts for 12 months ended 31 Dec. 1995	700,000

Other information in respect of the accounts for the year ended 31st December are as follows:

	1992	1993	1994	1995
	N	N	N	N
Depreciation Charged	20,000	50,000	55,000	70,000
Loss on Sales of Assets Included			(5,000)	

You are required to:

Advise with supporting computations on the new accounting year-end which the Nigerian company should adopt.

Suggested Solution

Format construction Nigeria Limited

The profits presented shall be adjusted for tax purposes

	1992	1993	1994	1995
	N	**N**	**N**	**N**
Profit per A/Cs	200,000	500,000	600,000	700,000
Add back: Depreciation	20,000	50,000	55,000	70,000
Loss on sale of assets	______	______	5,000	______
Adjusted profits	220,000	550,000	660,000	770,000

The year of change with the proposal is 1994 assessment year. The Revenue will compute as they think fit the assessments for 1994 (the year of change). On the basis of June, as the new accounting date:

Alternative 1: Old Accounting Date, 31/12		**N**
1994	1/1/93 to 31/12/93	550,000
1995	1/1/94 to 31/12/94	660,000
1994	1/1/95 to 31/12/95	770,000

Alternative 2: New Accounting Date, 30/6			**N**
1994	1/7/93 to 30/6/93	6/12x N220,000 + 6/12 x N550,000	385,000
1995	1/7/94 to 30/6/94	6/12x N550,000 + 6/12 x N660,000	605,000
1994	1/7/94 to 30/6/95	6/12x N660,000 + 6/12 x N770,000	715,000

Revenue compares the two, as follows:

Assessment Year	Old 31/12	New 30/6
	N	**N**
1994	550,000	385,000
1995	660,000	605,000
1996	770,000	715,000
Total for the three years	1,980,000	1,705,000

Revenue chooses the alternative that produces the higher assessable profits, that is, the assessments are:

	N
1994	550,000
1995	660,000
1996	770,000

On the basis of 30th September:

The alternative on the basis of the old accounting date of 31 December, will be as before.

The Alternative on the New Accounting Date, 30/9		N
1994	1/10/93 to 30/9/93 3/12x N220,000 + 9/12 x N550,000	467,500
1995	1/10/94 to 30/9/94 3/12x N550,000 + 9/12 x N660,000	632,500
1994	1/71094 to 30/9/95 3/12x N660,000 + 9/12 x N770,000	742,500

Revenue compares the two, thus:

Assessment Year	Old 31/12	New 30/9
	N	N
1994	550,000	467,500
1995	660,000	632,500
1996	770,000	742,500
Total for the three years	1,980,000	1,842,500

Cessation of trade or business

Year of Cessation-profits for the period 1 January to the date of cessation.

Penultimate Year- The assessment year before the year of cessation is termed the penultimate year. The assessment for this year which would have been based on the preceding year basis would be re-computed on actual year basis. If the amount assessable on actual basis is greater than that on preceding year basis, the Inland Revenue will opt to have the assessment for that year revised to actual year basis.

It is to be noted that it is the Revenue that has this option at cessation. The taxpayer's option is available at commencement.

Where a company which has permanently ceased to carry on a trade or business subsequently receives or pays any sum which would have been included in or deducted from the profits of that trade or business if it had been received or paid prior to the date of cessation such sum is treated as having been receive or paid on the date of cessation.

A company ceasing permanently to carry on a trade shall not be deemed to derive assessable of profits from such trade for the year of assessment following that in which the cessation occurs.

2.03 Loss Relief

Relief for trading losses is a topic that can be examined in the context of almost any income tax question. Consequently, the student must have a very sound grasp of the manner in which a tax payer can utilize trading loses. The module begins by describing the methods of loss relief. Next it proceeds with how to compute loss relief in the current year and carry forward. The module also describes how to deal with opening year losses and the circumstances in which the tax payer may obtain the benefits of double aggregation of the loss.

Methods of Loss Relief

When tax payers make profits, the Government through its agents Federal Board of Inland Revenue and State Internal Revenue Board will compute and collect taxes on profits. It therefore implies that whenever the tax payers incur losses, there ought to be a means of compensating them. However one crude way of doing it is to expect the Government at both levels to refund the amount of loss made by the tax payers. Where this is done, the business may become lackadaisical about its profitability objective.

However, the tax authority found solace in the principle of loss relief. The principle states that when a business unit incurs a loss in a particular accounting year or year of assessment, that loss can be deducted in future accounting year or year of assessment when the profit is made before the determination of tax liability.

Where a sole trader incurs a loss from his trade or business, relief is available against the profit of subsequent year. In the treatment of losses incurred by an individual there are two methods of relief's available. They are:

i. Carry forward loss relief; and

ii. Current year loss relief.

Current Year Loss Relief

i. It is available only to individuals i.e. only applicable under Personal Income Tax

ii. Losses are treated on actual year basic loss for the year ended 31/12/91 is treated as loss for 1991 YOA.

iii. Current year loss can be relieved from all sources of income accrued to the individual.

iv. For this relief to be granted a claim in writing must be made by the tax payer to the tax authority within twelve months after the year of assessment in which the loss was incurred.

v. Any amount of current year loss that is not fully relieved under the current year automatically becomes carry forward loss and when losses are carried forward they can only be relieved from the same source from which the loss was incurred originally.

It is important to note the application and the practice of law on loss relief:

i. Losses may only be carried forward for a maximum period of four years after which it lapses.

ii. Losses to be set-off may not exceed the actual loss incurred by a trade or business. This is important because where losses are used in aggregation; the aggregate loss will usually exceed the actual loss incurred. The difference between the aggregate losses and the actual loss is defined as a notional loss which is not available for relief.

Carry Forward Loss Relief

i. It is available to both individuals and corporate bodies.

ii. Losses can only be set off against the income from which the loss was incurred. This means the losses cannot be set-off against any other source of income.

iii. The relief is done on preceding year basis.

iv. There is no need for a written application by the tax payer as it is automatically granted.

v. Losses incurred by a property letting business can only be set-off under the carrying forward system.

Illustration of Loss Relief Carried Forward

Omosede & Sons Enterprises gives you the following information in relation to its financial position

	Year ended	Profit (Loss) N
	30/9/2012	(720,000)
	30/9/2013	320,000
	30/9/2014	420,000

Required: Show the procedure for his loss relief

Suggested Solution:

OMOSEDE & SONS ENTERPRISES

Procedure for showing Loss Relief

YOA	BP			N
2003	1/10/11 – 30/9/12		LOSS FTY	(720,000)
			URL c/f	720,000
2004	1/10/12 – 30/9/13		PROFIT	320,000
		LOSS b/f	(720,000)	
		Loss RTY	320,000	(320,000)
		URL c/f	400,000	
Total profit				0
2005	1/10/13 – 30/9/14			
			PROFIT	420,000

LOSS b/f		(400,000)
LOSS RTY	400,000	(400,000)
Total profit		20,000

KEY:

LOSS FTY - Loss for the years

URL C/F - Unrelieved loss carried forward

LOSS B/F - Loss Brought forward

LOSS RTY - Loss relieved in the year

Demonstration of Loss Relief (Lapsed Loss)

It must be borne in mind that prior to 1985 year of assessment, the tax payer relieved losses suffered against future adjusted profit until the loss is fully relieved. With effect from 1985 year of assessment till date with the exception of agricultural business which can relief losses indefinitely carrying forward of loss against future profit has been restricted to four years. Thereafter any outstanding residue shall become lapsed.

Illustration

The following information relates to Chief James Ovienmada Enterprises in Oyese Sopping Plaza businessman is as follows

Year ended Date	Detail	Adjusted Profit (N)
Year ended 30/6/99	Loss	(400,000)
Year ended 30/6/00	Adjusted Profit	100,000
Year ended 30/6/01	Adjusted Profit	40,000
Year ended 30/6/02	Adjusted Profit	20,000
Year ended 30/6/03	Adjusted Profit	20,000

Required: Demonstrate, using the above date the principle of lapsed loss.

Suggested Solution: Chief james Ovienmada Enterprises

Demonstration of Lapsed Loss.

YOA	Basis Period	Detail	N	N
2000	1/7/98 – 30/6/99	Loss (FTY)	(400,000)	
		C/F	400,000	
		Total Profit		
2001	1/7/99 – 30/6/00	Adjusted profit		100,000
		Loss b/f	(400,000)	
		Loss RTY	100,000	(100,000)
		UR c/f	(300,000)	
Total profit				0
2002	1/7/00 – 30/6/01	Adjusted profit		40,000
		Loss b/f	(300,000)	
		Loss RTY	40,000	(40,000)
		UR c/f	(260,000)	
Total profit				0
2003	1/7/01 – 30/6/02	Adjusted profit		20,000
		Loss b/f	(260,000)	
		Loss RTY	20,000	(20,000)
		UR c/f	(240,000)	
Total profit				0

2004	1/7/02 – 30/6/03	Adjusted profit		20,000
		Loss b/f	(240,000)	
		Loss RTY	220,000	(20,000)
		Lapsed	20,000	
Total profit				0

Note:

The loss of N400,000 incurred in 2000 year of assessment has been relieved consistently against adjusted profits for 2001, 2002, 2003, and 2004 years of assessment. After this, the residue of N220,000 was written off as lapsed.

It must be noted that the aggregate loss deduction from any assessable profit in any year of assessment shall not exceed the original loss incurred. Where the available loss exceeds the original loss incurred, the amount relievable shall be restricted to the original loss incurred i.e. the application of commencement rule may lead to a situation where the assessable loss is more than the initial loss incurred.

2.04 Capital Allowance

Under the PITA and the CITA depreciation of fixed assets is not allowed in computing the adjusted profits of any company in the accounting period under consideration. The reason for this is that for an item to be deductible under the PITA and CITA it must be of revenue in nature, rather than of capital nature. This notwithstanding a relief from taxation may be given in respect of capital expenditure by means of a system of capital allowances which are set against taxable profits. Consequently under the CITA and PITA a company that has incurred capital expenditure on plant, machinery, fixtures, pipelines, storage tanks, research and development etc. for the purpose of business or petroleum operations respectively is allowed to claim capital allowances in line of depreciation. Capital allowance therefore under the CITA and PITA is a form of standardized depreciation given under the income tax and petroleum tax laws on certain qualifying capital expenditures

Capital allowances are granted at varying rates on the cost of the asset. To qualify for capital allowances under the CITA and the PITA certain conditions must be met and they include:

i. The capital allowance must be claimed by the company except where the revenue authority is of the opinion that it is just reasonable to grant the allowance without a claim.

ii. The claimant must be the owner of the asset that is the subject of the claim. This notwithstanding, an asset acquired through a hire-purchase agreement or through an ordinary contract of hire or lease can be the subject of lease.

iii. The capital expenditure incurred must be for the purpose of the trade or business

iv. The expenditure must be incurred in the basis period, meaning the period of the profits on which any assessable income for that year of assessment falls to be computed, that is the preceding year.

v. The claimant must incur qualifying capital expenditure that include buildings, industrial buildings, mining, plant and machinery, furniture and fittings, public transportation, housing estate, agricultural plant, research and development, ranching and plantation, construction plant and manufacturing industrial plant.

There are basically four components of CA

i. Initial Allowance

ii. Annual Allowance

iii. Balancing Adjustment

iv. Investment Allowance

Initial Allowances

Initial allowance also known as first year allowance is the type of allowance that is claimed when the qualifying capital expenditure is first put to use. It is granted in the first year of acquisition on the cost of the purchase of the asset. It is applicable to both second hand and new asset except for buildings.

The initial allowance to be granted should be such an amount as the tax authority may determine to be just and reasonable irrespective of who has control of the asset (the seller or the purchase). Such an amount should not exceed the amount of the initial allowance which would have been allowable except for this provision plant and machinery for replacement of old ones is granted one of 95% capital allowance in the first year. In addition block value is also retained until the final disposal of the plant or machinery; provided that the aggregate capital allowances granted in respect of any asset not exceed 95% of the total cost of the asset (new section 6 (3) inserted in Act 1996 No. 32 effective from January 1996).

Annual Allowance

This type of allowance also known as written down allowance is claimed on a straight line basis over the estimated tax life of the qualifying capital expenditure. The estimated tax life is computed using the formula:

$$\frac{100}{\text{Annual allowance rate}}$$

It is granted annually and is computed on the balance of cost after the deduction of the amount of initial allowance claimed on the asset. For example if you bought an assets of N100,000 and assuring that the annual allowance rate is 25% and initial allowance is 50% the annual allowance shall be N12,500 that is 25% of (N100,000 – N50,000)

When the basis period for any year of assessment is a period less than one year, the annual allowance for the year of assessment shall be proportionately reduced.

Illustration

Isiuwa Limited commenced business as an auto repair business on October 1st, 2013 and its accounting year ends September 30th of every year. During this period, it made the following capital expenditure on plan and machinery

1/10/2013	N1,040,000
1/11/2013	N1,070,000
15/04/2014	N1,450,000

The annual allowance for the first year of assessment shall be as follows:

First year of assessment will be 2013 assessment year Basis period for capital allowances period

1/10/2013 to 31/12/2013	N
Total qualifying expenditure during that period	2,110,000
Less initial allowance of 50%	1,055,000

Balance of cost after initial allowance		1,055,000
Investment allowance due	N	
Plant and Machinery	211,000	
Annual allowance		
For a full year at 25% of 1,055,000	263,750	
It is restricted to $^{2}/_{12}$ x N263,752 as a result		
Of the number of months in the basis period		
being less than twelve		65,392
Residue expenditure carried forward in the second year of assessment		989,062

it is essential to note that animal allowance is an annual basis as a result it is proportionally restricted to the number of months in the basis period if it is less than twelve months.

Balancing Adjustment

Balancing adjustment arises when a qualifying capital expenditure is disposed of or is deemed to have been disposed of. This is obtained by comparing the sales proceeds on the disposal to the tax written down value of an asset as at the time of the disposal. Essentially there are two types of disposal in balancing adjustments:

i. **Balancing Charge:**

When an asset is disposed of and the written down value of the asset is lower than the net sale proceeds of the asset, the difference is treated as a balancing charge. A balancing charge cannot exceed the actual capital allowances granted on the asset before disposal.

ii. **Balancing Allowance:**

When an asset is disposed and the written down value of the asset is higher than the net sale proceeds of the asset the difference is treated as a balancing allowance. It is deducted from the assessable profit to arrive at the chargeable profit of the organization. It is treated as an additional allowance to be used in reducing the profits to be subjected to taxation; and it is treated in similar manner as both initial and annual allowances in that they can be carried forward when utilized in any year.

Illustration

Izoduwa Limited, a furniture construction company in 2012 disposed of the under listed qualifying expenditure:

i. Motor vehicle with tax written down value of N519,300 was disposed for N1,000,000. The original value was N1,300,000.

ii. A set of office furniture and equipment was sold for N300,000. Its original cost was N600,000 and tax written down value as at the time of disposal was N359,000

iii. A building purchased for N1,500,000 in 2011 was disposed, with a tax written down value of N697,500 for N2,500,000.

Required:

Compute the balancing Adjustment

Solution:

	Building	Motor Vehicle	Furniture
	N	N	N
Sales Proceeds	2,500,000	1,000,000	300,000
Less:			
Tax Written Down			
Value (TWDV)	697,500	519,300	359,000
Balancing charge	1,802,500	480,700	
Balancing Allowance			59,000

The balancing charge for building would be limited to N402,250 (N1,500,000 – N697,500) which represent the maximum capital allowances already claimed on the qualifying capital allowance as at the time of disposals. There will be no limit on the amount taxable for the motor vehicle the amount N480,700 does not exceed capital allowance already claimed on the asset of N780,700 (N2,500,000 – N519,300).

It must be noted that excess of the sale proceeds over the original cost of the asset is subject to capital gains tax.

Balancing charge is regarded as an income and it is to be added to the adjusted profit of the business during the year of assessment in which it arises. Balancing allowance on the other hand is treated as a component capital allowance and is to be deducted from the assessable profit to arrive at taxable profit.

Investment Allowance

This is an investment granted to companies that are incurred on qualifying capital expenditure with respect to plant machinery and equipment for the purpose of the business. The allowance is granted at 10% of the cost of asset as follows:

i. With effect from 1985 year of assessment 10% investment allowance is granted on plant equipment used for agricultural business

ii. With effect from 1990 year of assessment 10% investment allowance on plant equipment and machinery used for manufacturing business

iii. With effect from 1991 year of investment 10% investment allowance to plant and equipment used for any other business.

Businesses that are located not less than 20km from normal facilities are entitled to "Rural Investment Allowance. The conditions under which it can be claimed include:

i. Where there is no electricity 50% of the cost incurred in providing electricity.

ii. Where there is no water 30% of cost incurred.

iii. Where is no tarred road, 15% of the expenditure incurred.

iv. Where there is no telephone, 5% of the expenditure incurred.

v. Where there is no facility at all 100%

Features of investment allowance include the under listed:

i. It is claimable only once in the life of an asset and it must be in the year the asset was first put in use.

ii. It is claimable only on plant, machinery and equipment.

iii. Where rural allowance is fully absorbed in the year it was incurred, it cannot be carried forward.

iv. Investment allowance is not to be taken into consideration in arising at the TWDV carried forward.

Basis Period for Capital Allowance

The basis period for capital allowance for an ongoing business is the same as the basis period for profit i.e. on proceeding year basis. The purpose for determining the basis period for capital allowance is to enable us to know:

(i) The relevant period a particular capital expenditure was put into production and used for the first time.

(ii) The year of assessment that should benefit from initial allowance on a qualifying capital expenditure.

(iii) The number of months in a basis period so that annual allowance can be apportioned in appropriate time proportions.

(iv) The procedure of calculating capital allowance during commencement and cessation of trade or business

However, where a business has just commenced, changes its accounting year end or has permanently ceased to trade, special rules will be applied in determining the basis period for capital allowance.

Overlapping Basis Period

This arises when a determinable basis period is common to two or more years of assessment. When this happens, we say there is the problem of overlapping. Overlapping basis period can be partial or total. It is partial if only a given period lesser than the period in each of the two or more relevant years of assessment is common and total if there is complete resemblance of two basis periods as we may sometimes have when the repetitive role is applied. This is usually applied where a business has just commenced.

Illustration

Given the following information relating to Amenaghawon Enterprises, assume that the business started its operation June 1st 2004. You are required to compute the Basis Period for capital allowances

Basis period for profit

YOA	**BP**
2004	1/6/2004 – 31/12/2004
2005	1/6/2004 – 30/05/2005
2006	1/6/2004 – 30/05/2005
2007	1/6/2005 – 30/05/2006

Basis period for capital allowance

YOA	**BP**
2004	1/6/2004 – 31/12/2004
2005	1/6/2005 – 30/05/2005
2006	–
2007	1/6/2005 – 30/05/2006

YOA- means Year of Assessment

BP- means Basis Period

Illustration

Oladunni Enterprises is a going concern business with the following date.

1/1/2004 – 31/12/2004

1/1/2005 – 31/12/2005

1/1/2006 – 30/06/2007

1/7/2007 – 30/06/2008

	1/7/2008 – 30/06/2009
	1/7/2009 – 30/06/2010

YOA	**BP for profit**
2005	1/1/2004 – 31/12/2004
2006	1/1/2005 – 31/12/2005
2007	1/7/2005 – 30/06/2006
2008	1/7/2006 – 30/06/2007
2009	1/7/2007 – 30/06/2008

YOA	**BP for capital allowance**
2005	1/1/2004 – 31/12/2004
2006	1/1/2005 – 31/12/2005
2007	1/7/2005 – 30/06/2006
2008	1/7/2006 – 30/06/2007
2009	1/7/2007 – 30/06/2008

Illustration

Akpojaro Nig. Ltd commenced business on 1st October 2004 making up its accounts to 31st March each year. On 31st July 2008. The company ceased trading.

You are required to show the basis period for capital allowance for all relevant period.

Suggest Solution:

YOA	**BP PROFIT (PYB)**
2004	1/10/2004 – 31/12/2004
2005	1/10/2004 – 30/09/2005
2006	1/10/2004 – 30/09/2005
2007	1/04/2005 – 31/03/2006

2008	1/01/2008 – 31/07/2008

On Actual Year of the preceding Year Basis of the Penultimate year:

YOA	**BP FOR PROFIT (PYB)**
2004	1/10/2004 – 31/12/2004
2005	1/10/2004 – 30/09/2005
2006	1/10/2004 – 30/09/2005
2007	1/01/2007 – 31/12/2007
2008	1/01/2008 – 31/07/2008

YOA	**BP OF CAPITAL ALLOWANCE**
2004	1/10/2004 – 31/12/2004
2005	1/01/2005 – 30/09/2005
2006	–
2007	1/10/2005 – 31/03/2006
2008	1/01/2008 – 31/07/2008

Restrictions of Capital Allowance

In accordance with the Finance Miscellaneous Taxation Provision Decree 1985, the amount of capital allowance to be deducted from assessable profit in any year of assessment is:

i. 75% of such assessable profit in case of manufacturing business with effect from 1988. It is no more limited to 75%; it is now treated like agro allied industry.

ii. 662/3% of such assessable profit in case of any other business.

iii. Any company in the Agro Allied Industry shall not be affected by the above restriction.

The restriction of capital allowance is applicable to all types of capital allowances i.e.

i. Initial capital allowance

ii. Annual capital allowance

iii. Balancing allowance

iv. Investment allowance

v. And unabsorbed capital allowance b/f

Illustration

Ighomaro and SONS Limited has 99,000 as an assessable profit for the year ended 31st December 2006. Capital allowance for the year is N120,000. You are required to determine the capital allowance claimable and the adjusted profit for the year.

Suggested Solution

	N	N
Assessable Profit		99,000
Less capital allowance	120,000	
Restriction 662/3% of 99,000	66,000	
Capital allowance absorbed		66,000
Chargeable profit		33,000

Illustration

Mrs. Okosun commenced her business of manufacturing ceramics on 1st 2010. The following are particulars of capital expenditure incurred by him during the period 1st September 2009 to 39th June, 2010

	N
Factory Building	50,000
Plant and Machinery	100,000
Motor Vehicles	20,000

Other additional purchases are as follows:

Date of Purchase	Item Purchased	Cost (N)
August 2010	Plant	20,000
January 2011	Lorry	15,000
June 2011	Building	70,000
December 2011	Cutting Machine	30,000
May 2012	Extension of factory	15,000
September 2012	Lorry	10,000

The accounts are made up to 30th June each year,

You are required to state clearly:

i. The relevant years of assessment.

ii. The basis period for the assessment years.

iii. The capital expenditure on which capital allowance are claimable for all relevant years of assessment on the following basis:

   a. Normal basis.

   b. On the basis that a claim has been made for revision of the second and third years of assessment

Suggested Solution:

MRS. OKOSUN

SCHEDULE OF CLAIMABLE ALLOWANCE

Normal Basis

Year of Assessment	Basis Period for profit	Basis period for capital allowance	Qualifying capital expenditure	Amount N
1990	1/7/90 – 31/12/90	1/7/90 – 31/12/90	Factory Building Plant & Machinery	50,000
			100,000 + 20,000	120,00
			Motor vehicles	<u>20,000</u>
			Lorry	15,000
1991	1/7/90 – 30/06/91	1/7/91 – 30/06/91		
			Building	<u>70,000</u>
			NII	NII
1992	1/7/90 – 30/06/91	NII		
			Plant-cutting	
1993	1/7/91 – 30/06/92	1/7/91 – 30/06/92		
			Machine	30,000
			Extension of factory	
			Motor Vehicle	<u>15,000</u>
			Lorry	
1994	1/7/90 – 31/12/90			
				<u>10,000</u>

Revised Basis

Year of Assessment	Basis Period for capital allowance	Basis period for capital allowance	Qualifying capital expenditure	Amount N
1990	1/7/90 – 31/12/90	1/7/90 – 31/12/90	Factory Building Plant & Machinery	50,000
			100,000 + 20,000	
				120,00
			Motor vehicles	20,000
			Lorry	15,000
1991	1/1/91 – 31/12/91	1/1/91 – 31/12/91		
			Building	70,000
			Plant & Mach.	
		1/1/92 – 31/12/92		
			Cutting Mach.	<u>30,000</u>
			Extension of Factory	
1992	1/1/92 – 31/12/92	1/1/91 – 30/06/92		
			Motor Vehicle	15,000
			-Lorry	
				10,000
			Nil	
				<u>Nil</u>
1993	Nil	Nil		

Illustration

Baba Kile Nigeria Limited a resident company makes up accounts each year to 31st October. It occupies a factory which it bought on 1st November 2004, the cost comprising:

	₦
Land	20,000
Preparation of site	10,000

Factory	110,000
Warehouse unit	30,000
	170,000

On 1st November 2006 the company bought two additional factories:

i. A second-hand factory which costs it ₦180,000. The factory's construction had cost the original owner 60,000 on 1st of November 2000.

ii. A newly – constructed factory which cost ₦1,000,000 (including ₦260,000 for office accommodation).

Required:

Compute the maximum industrial building allowance (IBA) which may be claimed by Baba Kile Nigeria Limited for the relevant years of assessment up to 2008.

Suggested Solution:

BABA KILE NIGERIA LIMITED

Computation of Capital Allowances on Factory Building

	Old	New	Second Hand	Total
Rate 15/10	₦	₦	₦	₦
2006 cost	150,000	740,000	60,000	
I.A.	(22,500)	(111,000)	-	133,500
A.A.	(12,750)	(62,900)	(6,000)	81,650
				215,150
2007 TWDV	114,750	566,100	54,000	
A.A.	(12,750)	(62,900)	(6,000)	81,650
2008 TWDV	102,000	503,200	48,000	
A.A	(12,750)	(62,900)	(6,000)	81,650
TWDV	89,250	440,300	42,000	

Notes:

i. Capital allowance is not claimable on cost of land;

ii. Where a building is acquired on second hand, capital allowance (annual allowance only) will be claimed on the lower of original cost to the vendor and the actual purchase price.

Calculation of Capital Allowance on Hire Purchase Assets

A company or an individual tax payer wanting to preserve liquid fund or that falls short of it may desire to enter into hire purchase agreement. Such an agreement usually makes the payment flexible which is done instalmentally. Since payment is not made at once but piecemeal, such an arrangement will attract some interests on cost. Thus, usually the cost of acquiring an asset on hire purchase will be higher than the cost of outright purchase by the margin of the interest charged as per agreement.

Under hire purchase transaction an initial deposit will be made to be followed by subsequent installments. The hire purchase interest element is an allowable expenditure in arriving at adjusted profit. It is therefore not considered for capital allowance computation. It is normally debited to-the Profit and Loss Account as an expense. Under a hire purchase transaction, the hirer of the asset is treated as it owns the asset subject to the following modification:

i. The amount of expenditure to be capitalized is limited to the deposits and installments actually paid for during the year of assessment,
ii. The installment payment will exclude hire purchase interest element. Therefore, for each year of assessment capital allowance will be computed on the deposit and the capital position of installment actually paid during the year.

Under hire purchase the life of a qualifying capital expenditure may be extended beyond the expected life for tax purposes. Where this occurs, the problem can be solved by ensuring that the expected life used in computing annual allowance is progressively reduced as we approach the end the useful life of the asset.

Steps to Follow

i. Determine the interest element in the whole hire purchase transaction.
ii. Determine the interest element per installment. This is equal to total interest element divided by the number of installments.

iii. Determine the capital portion per installment. This is equal to amount payable by installments less interest element per installment.
iv. Prepare a payment schedule taking into consideration the deposit paid and the capital portion per installment
v. Determine the basis period for capital allowance
vi. Compute the capital allowance.

Mayor Offa Service Limited has been in business for years and makes up its accounts to 30th June each year. The company normally acquires new assets for use in its business on here purchase.

On 1st July 2001, it acquired some Lorries on the following terms: Deposit of 1st July 2001, it acquired some Lorries on the following terms. Deposit on purchase ₦250,000 followed by three equal yearly payments of ₦270,000 each payable on 30th September of every year. The first installment was due on 30th September, 2001.

The cash price of the Lorries when newly purchased was 945,000. The taw written down value of the existing assets at the end of 2001 tax year was ₦490,000. The assets were acquired on 17th of August 1998.

You are required to compute the capital allowances for 2002, 2003, 2004, 2005 and 2006 years of assessment, assuming that the installments were paid on their due dates and that the capital allowances were claimable at 20% initial and 10% annual

Suggested Solution:

Okwokwo Services Limited

Computation of Capital Allowances

TWDV DEPOSIT

b/fwd&

			1st Installment	2nd Installment	3rd Installment
			₦	₦	₦
2002	TWDV b/fwd	490,000			
	A.A.	(61,250)			
2003	TWDV	428,750			
	Additional	-	481,667		
	I.A.	-	(96,333)		
	A.A.	(61,250)	(38,533)		
2004	TWDV	367,500	346,801		
	Additional	-	-		231,667
	I.A.	-	-		(46,333)
	A.A.	(61,250)	(38,533)	(20,593)	
2005	TWDV	306,250	308,268	164,741	
	Additional	-	-	-	231,666
	I.A.	-	-	-	(46,333)
	A.A.	(61,250)	(38,533)	(20,593)	(23,167)
2006	TWDV	245,000	269,735	144,148	162,166
	A.A.	(61,250)	(38,533)	(20,593)	(23,167)
		183,750	231,202	123,555	138,999

Notes:

i. When an asset is acquired on hire purchase terms, only the capital element of the installment paid in a basis period is entitled to capital allowances claim. The interest element will be written off to the Profit and Loss Account.
ii. Where qualifying capital expenditure is acquired on hire purchase terms, the expected life may be extended beyond the useful life. This problem may be solved by reducing the estimated useful life as one approaches the end of the useful life if the asset, for example, the useful used life in calculating the A.A. on additions in 2004 is 9 years.
iii. The rates of capital allowance to be used have been given. This explains why the change in rates have been ignored

Okonkwo Services Limited

Hire Purchase Price

250,000 + (270,000 x 3)

250,000 + 810,000	=	1,060,000
Cash price	=	945,000
Interest element		₦115,000
Interest per installment 115,000/3		38,333
Capital portion per installment	=	270,000 – 38,333
		231,667

Payment Schedule

1/7/01	Deposit	₦250,000
30/9/01	1st Installment	₦231,667
30/9/02	2nd Installment	₦231,667

YOA	**BASIS PERIOD**	**QCE**
2002	1/7/00 – 30/6/01	TWDV b/fwd
2003	1/7/01 – 30/6/02	Deposits & 1st Installment
2004	1/7/02 – 30/6/03	2nd Installment
2005	1/7/03 – 30/6/04	3rd Installment
2006	1/17/04 – 30/6/05	

Illustration

Ekunwe Nigeria Limited is a company engaged in manufacturing goods for export and makes up its accounts to 30th November. All plants and equipment of the company are normally acquired on hire purchase terms.

On 1st December 2002 it acquired several plants and equipment on the following terms. Deposit of ₦750,000 followed by six and a half yearly installments of ₦120,000 each payable on. 1st December and 1st June of each year; the first installment being due on 1st June 2003. The interest element per installment is 15% of each half yearly installment. You are required to compute the capital allowances as for all relevant years up to 2008 tax year. Given the capital allowance rate to be initial 25% and annual to be 10%.

Suggested Solution Ekunwe Nigeria Limited

Computation of Capital Allowances

		Deposit & Instalment	2nd & 3rd Instalment	4th & 5th Instalment	6th Instalment	Total Allowance
			₦		₦	₦
Rates		25/20				
2000 Cost		852,000				
	I.A.	(213,000)				213,000
	A.A.	(63,900)				63,900
Investment Allow.		-				85,200
2001	TWDV	575,100				362,100
	Additional	-	204,000			
	I.A.	-	(51,000)			51,000
	A.A.	(63,900)	(17,000)			80,900
Investment Allow.		-	-			20,400
2002	TWDV	511,200	136,000			152,300
	Additional	-	-	204,000		

	I.A.	-	-	(51,000)		51,000
	A.A.	(63,900)	17,000	(19,125)		100,025
Investment Allow.		-	-	-		20,400
2003	TWDV	447,300	119,000	133,875		171,425
	Addition	-	-	-	102,000	
	Initial	-	-		(25,500)	25,500
	Annual	(63,900)	(17,000)	(19,125)	(10,929)	110,954
	Investment	-	-	-	-	10,200
2004	TWDV	383,400	102,00	114,750	65,571	146,654
	A.A.	(63,900)	(17,000)	(19,125)	(10,929)	110,954
	TWDV	319,,500	85,000	95,625	54,642	

Workings

Ekunwe Nigeria Limited

Purchase of Plants and Equipment on Hire Purchase Terms	₦
Amount per instalment	120,000
Interest per installment (15% of 120,000)	18,000
Capital portion per installment (₦120,000 – ₦18,000) = 102,000	
Deposit	₦750,000

Payment Schedule

Deposit	1/12/02	₦750,000
1st Instalment	1/6/03	₦102,000
2nd Instalment	1/12/03	₦102,000
3rd Installment	1/6/04	₦102,000
4th Installment	1/12/04	₦102,000
5th Installment	1/6/05	₦102,000
6th Installment	1/12/03	₦102,000

Basis Period for Capital Allowance

YOA	Basis Period	Instalmental Deposit
2004	1/12/02 – 30/11/03	Deposit 1st Installment
2005	1/12/03 – 30/11/04	2nd& 3rd Installment
2006	1/12/04 – 30/11/05	4th& 5th Installment
2007	1/12/05 – 30/11/06	6th Installment
2008	1/12/06 – 30/11/07	

Disposed of

(i) A building, structure or works of a permanent nature is disposed of if any of the following events occur:

(ii) the relevant interest is sold; or

(iii) that interest, being an interest depending on the duration of a concession, comes to an end on the coming to an end of that concession; or

(iv) that interest, being a leasehold interest, comes to an end otherwise than on the company entitled thereto acquiring the interest which is reversionary thereon; or

(v) the building, structure or works of a permanent nature are demolished or destroyed or without being demolished or destroyed, cease altogether to be used for the purposes of petroleum operations carried on by the owner thereof.

(vi) Plant, machinery or fixtures are disposed of if they are sold, discarded or cease altogether to be used for the purposes of petroleum operations carried on by the owner thereof.

(vii) Assets in respect of which qualifying drilling expenditure is incurred are disposed of if they are sold or if they cease to be used for the purposes of petroleum operations of the company incurring the expenditure either on such company ceasing to carry on all such operations or on such company receiving insurance or compensation moneys thereof

Value of an Asset

The value of an asset at the date of its disposal:

(a) Is the net proceeds of the sale thereof or of the relevant interest therein, or

(b) If it was disposed of without being sold, the amount which, in the opinion of the Board, such asset or the relevant interest therein, as the case may be, would have fetched if sold in the open market at that date, less the amount of any expenses which the owner might reasonably be expected to incur if the asset were sold, or

(c) If an asset is disposed of in such circumstances that insurance or compensation monies are received by the owner thereof, the asset or the relevant interest therein, as the case may be, shall be treated as having been sold and as though the net proceeds of the insurance or compensation monies were the net proceeds of the sale thereof

(d) Owner and Meaning of Relevant Interest

Where an asset consists of building, structure or works the owner thereof shall be taken to be the owner of the relevant interest in such building, structure or works.

The "relevant interest" means, in relation to any expenditure incurred on the construction of a building, structure or works, the interest in such building, structure or works to which the company which incurred such expenditure was entitled when it incurred the expenditure.

Where a company incurs qualifying building expenditure or qualifying drilling expenditure on the construction of a building, structure or works, the company is entitled to two or more interest therein, and one of those interests is an interest which is reversionary on all the others, that interest shall be the relevant interest.

Sale of Building

Where qualifying expenditure has been incurred on the construction of a building, structure or works and thereafter the relevant interest therein is sold, the following rules shall apply:

i. Where the building, etc. has been used by the original owner before sale, the second-hand purchaser is deemed, for all the purposes of capital allowances except the granting of petroleum investment allowance, to have incurred qualifying capital expenditure equal to the price paid by it for the building or to the original cost of construction, whichever is lower.

ii. Where the building has not been used by the original owner before sale, the second-hand purchaser is deemed, for all the purposes of capital allowances, to have incurred qualifying capital expenditure equal to the original cost of construction. In effect, the original cost of construction is taken to be the amount of the purchase price on such sale.

iii. Where any such relevant interest is sold more than once before the building, etc. is used, the provisions of sub-paragraph (b) shall have effect only in relation to the last of those sales.

Disposal without Change of Ownership

Where an asset has been disposed of in such circumstances that the owner still remains the owner after the disposal, then, for the purposes of determining an annual or balancing allowance or balancing charge in respect of the use of the asset after the date of such disposal:

(a) The qualifying expenditure incurred by the owner on such asset before the date of disposal shall be left out of account;

(b) The owner is deemed to have bought the asset immediately after the disposal at a price equal to the residue of the qualifying expenditure (i.e. the written down value of the asset) at the date of the disposal plus the amount of any balancing charge or minus the amount of any balancing allowance arising from the disposal.

Tax Distortion under Inflationary Conditions

A lot has been discussed in the accountancy profession with regards to Inflation Accounting.

In view of rising prices, the surplus of sale proceed over costs when an item is disposed is not necessarily profit. Part of such is indeed due to the effect of inflation. This will be more pronounced when capital assets are involved. Since capital assets would be retained for a couple of years before disposal, the cumulative effect of the gains due to inflation would be significant. This is properly recognized in the United Kingdom where the gains due to inflation is first removed by what is termed indexation allowance and it is the net gain (that is after removing the gains due to inflation) that is subjected to capital gains tax.

In a period of rising prices as exists in Nigeria, part of the profit made by a trading concern will be due to the effect of inflation. To the extent that the profit is due to the effect of inflation, it will usually be used for trading stocks replacement purposes. It is not a profit that can be distributed and such should also (should the tax laws permit) not be subject to tax. If such is not ploughed back into the business and no alternative arrangement is made by the company, the operating capacity of the business will be gradually eroded to the extent that the business will be unable to continue trading.

The true profit of a trading concern, for example, can only be arrived at after appropriate provision has been made for trading stock replacements. This will be such that, at least, the same volume of operation can be maintained in the following year as for the current year.

Illustration

XYZ limited company started trading in year 1 with 50, 000 units of stock at ₦60 per unit. By the end of the year all the stocks have been sold. Due to inflation the unit price of the trading stocks by the end of the year has increased by 20% to ₦72 per unit.

Were the company to maintain the same volume in year 2 as in year 1, a total amount of ₦3,600,000 (50,000 units at ₦72 per unit) would be required to replace the stocks that generated the sales figure of ₦5 million. Under the correct principle of Inflation Accounting according to the proponents of inflation accounting, the cost of sales to be charged to the trading profit and loss account in Year 1 should be the replacement cost of the stocks sold. A second trading profit and loss account under Inflation Accounting could be prepared below showing the operating result of the company.

Suggested Solution **XYZ Limited Year 1**

Trading, Profit and Loss Account

		₦	₦
(a)	Historical Costs	₦	₦
	Sales (50,000 units)		5,000,000
	Less Cost of sales (60% of sales)		3,000,000
	Gross Profit		2,000,000
	Deduct expenses:		
	Rent and rates	300,000	
	Travelling	600,000	
	Printing, postages and stationary	100,000	
	Telephone and courier	200,000	
	Others	300,000	(1,500,000)
	Net Profit		500,000
	Income Tax at 30% (assuming Accounting profit same as tax profit and Ignoring commencement rules)		150,000
(b)	Inflation Accounting Costs	₦	₦
	Sales (50,000 units)		5,000,000
	Less Cost of sales (72% of sales)		3,600,000
	Gross Profit		1,400,000
	Deduct expenses:		
	Rent and rates	300,000	
	Travelling	600,000	
	Printing, postages and stationary	100,000	
	Telephone and courier	200,000	
	Others	300,000	(1,500,000)
	Net loss		(100,000)
	Income Tax at 30% (assuming Accounting profit same as tax profit and		NIL

Ignoring commencement rules)

To maintain the same operating capability of 50,000 units in year 2 as in year 1 would require ₦3,600,000 purchases (50,000 units at ₦72 per unit). For simplicity, it is assumed that the unit prices of the expense items would remain the same. In practice, these would also be affected by inflation and ought to have been reviewed upwards for the effect of inflation.

Taxation Impact

With the accounts prepared under the historical cost convention, income tax of ₦150,000 would be payable whereas with the accounts prepared under the inflation accounting principle, the company has incurred a trading loss of ₦100,000 and its income tax liability will be NIL.

The distortion is that this company is required to pay a tax of ₦150,000 whereas in view of the inflation spiral, its tax liability should have been NIL.

2.05 Accounting for Taxes

Taxes are amounts levied by government on businesses and individuals to finance its expenditures, to regulate the economy, to distribute wealth and for a number of other reasons.

Taxable income is the income determined using Internal Revenue Code rules and regulations. It is the amount of income on which the entity will actually pay income **tax** in the current **accounting** period. Deferred **taxes** arise as a result of temporary difference between income **tax** expense and income **tax** payable.

Accounting used in issuing financial statements is not the same as the accounting used for tax purposes. While Accounting for tax purposes is governed by tax law; Accounting for financial statement purposes is governed by GAAP.

There are different ways in which governments collect and calculate taxes. Direct taxes are taxes that are paid by businesses which also ultimately bear them. They are normally based on the business's net income. Indirect taxes are taxes which are initially paid by businesses but ultimately transferred to the end users of the taxed product. They are normally based on revenue.

Examples of direct taxes include:

(i) Corporation income tax

(ii) Employer portion of the social security contributions

Examples of indirect taxes include:

i. Sales tax

ii. Value added tax

iii. Import tax

The main difference between direct tax and indirect tax from the perspective of a business that pays it is that a direct tax results in expense and liability while an indirect tax results in a liability but not an expense.

Direct tax and indirect tax have different accounting implications for a business.

Accounting for direct taxes

Income taxes are levied on a business by applying a percentage to the business's net income calculated in accordance with the accounting rules given in the relevant tax laws. It results in an amount which is recorded as the business' expense and liability when it becomes due.

2.06 Review Questions

1. Ana, Inc. is a manufacturer of water sports equipment. It sold 990 speed boats in financial year 2014 for #50 million in total. The company's total expenses for the period amounted to #28 million. Since tax accounting rules are different than the financial accounting rules, net income for the income tax purpose is different than the financial accounting net income. The company's tax accountant determines that the company's revenue for the period under tax accounting rules equals #48 million while its allowable expenses are #23 million. Calculate the income tax the company shall pay if the relevant tax rate is 30% and journalize the transaction.

Solution

Revenue under tax accounting rules	#48,000,000
Less: expenses under tax accounting rules	#23,000,000
Net income under tax accounting rules i.e. taxable income	#25,000,000
Income tax @ 30% ($25 million * 0.30)	#7,500,000

This #7.5 million is the company's expense for the period which results in a company's obligation to the government. The transaction is recognized in the company's books as follows:

Income Tax	#7.5 M	
Income Tax Payable		#7.5 M

Accounting for indirect taxes

Indirect taxes are taxes that are not based on net income. They are normally based on revenue.

In case of indirect taxes on revenue, for example a tax on goods and services, a business is required to collect an amount from its customers on each unit it sells to them and deposit it with the government.

2. XYZ, Inc. provides cleaning services to, ABC Inc. Under the relevant tax laws, XYZ is required to collect a sales tax on services from ABC, Inc. at the rate of 15%. During the financial year 2014, ABC, Inc. provided services worth #3 million to XYZ, Inc. Explain how will ABC, Inc. account for the transaction.

Solution

Sales tax XYZ, Inc. is required to collect from ABC, Inc. = 15% * #3 million = #0.45 million

XYZ, Inc. shall invoice ABC, Inc. for an amount which shall be the sum of the sale price and the sales tax, i.e. #3.45 million (#3 million + #0.45 million). XYZ, Inc. shall deposit the sales tax of #0.45 million collected from ABC, Inc. with the government.

XYZ, Inc. shall pass the following journal entry:

Accounts receivable/cash	#3.45 M	
Sales		#3 M
Sales tax payable		#0.45 M

When XYZ, Inc. deposits the #0.45 million with government, its liability related to the sales tax shall extinguish:

Sales Tax Payable	#0.45 M	

Cash		#0.45 M

From the perspective of ABC, Inc. the sales tax it has paid to XYZ, Inc. becomes its expense and shall form part of the cost of cleaning services. ABC, Inc. shall record the transaction as follows:

Cleaning Expense	#3.45 M	
Accounts Payable/Cash		#3.45 M

MODULE 3

3.00 PERSONAL INCOME TAX

3.01 Learning outcome

On successful completion of this Module, Students should be able to:

i. Evaluate Personal Income Tax administration and how to deal with the tax authorities in connection with it;
ii. Compute adjusted profits of Individuals in Trade, Partnership, Trusts, etc;
iii. Examine the principles of allowable and non-allowable deduction as applicable to personal income tax in Nigeria;
iv. Compute capital allowances for Individuals and corporate entities in Nigeria;
v. Prepare personal Income tax computations in accordance with the provision of PITA.

3.02 Income Chargeable to Tax

The history of taxation could be traced to the history of human creation, as taxation is a divine order. In Islam, Muslims have been enjoined to remit a portion of their reserved wealth annually for spiritual cleansing, which is called zakat. The remittance is made as specified in Quran (9:60) to the needy and this serves as a means of income redistribution. In Christendom, Christians are also required to remit one-tenth of their income for the purpose of income redistribution and portion remitted is called tithe. In Nigeria, the history of personal income taxation can be traced to the pre-colonial era. At that time, there were emirates, kingdoms and chiefdoms which were ruled by emirs, Ezes, Obas and Attas etc. The system finances its activities through proceeds of taxes levied on subject of the various emirates. Taxes that were paid in these emirates include: zakat, kudin kasa, and jangali. Zakat is a form of tax paid by all eligible Muslims while kudin kasa is an agricultural tax, and jangali is cattle tax. In Southern Nigeria, taxes were also paid in the kingdoms and chiefdoms. The taxes were paid in form of tributes, tolls and levies. These taxes were used to maintain the kingdoms and chiefdoms. When the British people came, they capitalized on the administrative system in the North and introduced the indirect rule where they ruled the people through the emirs. The then high commissioner for Northern Nigeria harmonized all the traditional taxes under the native revenue proclamation No. 4 of 1904 and the native revenue proclamation No. 2 of 1906. The tax rates were fixed by the government while assessment and collection were done by the local authorities. The tax revenue was divided equally by the government and local authorities.

Taxation was introduced in the western part of the country (excluding Asaba division and Warri province) in 1918 by the enactment of the Native Revenue Ordinance. In 1927, the Native

Revenue (amendment) Ordinance was enacted and consequently taxation was introduced in the eastern province, Warri province and Asaba division. However, the introduction of taxation in some parts of this province was met with some resistance. There were some disturbances in Warri and Ogoja provinces. The famous Aba riot of 1929 is a case in point.

There were various ordinances that were enacted which include the Non-Native (Protectorate) Ordinance of 1931 and that of 1937. These two ordinances were for non-native. That of 1937 replaced the one of 1931. There were also the Native Direct Taxation (Colony) Ordinance of 1937 and the Colony Taxation Ordinance of 1937. The former was repealed for Nigerians residing in the colony provinces and the later applied to Lagos. These Ordinances were replaced by the Direct Taxation Ordinance No. 4 of 1940 and the Income Tax Ordinance No.3 of 1940. The Direct Taxation Ordinance applied to all Nigerians excluding those residing in Lagos. The Income Tax Ordinance was for expatriates and Nigerians residing in Lagos. Other laws were enacted in 1943 i.e. Income Tax Ordinance of 1943 and Direct Taxation (Amendment) of 1943. These laws repealed those of 1940.

In 1952, Nigeria became a federation with regional governments. Consequently, the assessment and collection of taxes were done by regional governments but this was in respect of taxes paid by Africans. In 1962, the regional governments were allowed to assess and collect taxes from Non-Africans. The eastern region was the first region that enacted the law that replaced the Direct Taxation Ordinance. The region passed a law known as the Finance Law No. 1 of 1956 which introduced the Pay-As-You-Earn (PAYE) System. There was also the Eastern Region Finance Law of 1962 which repealed that of 1956. The Law (Eastern Region Finance Law of 1962) was adopted by the eastern States with amendments. The next region was the western region, that enacted the Income Tax Law in 1957 and this repealed the Direct Taxation Ordinance of 1943. Another law came into effect in the western region in 1961. The law introduced the Pay-As-You-Earn System and it also applied to non-Africans. The law was later adopted by the western States but with amendments. The Northern Region joined the other regions in 1962 by enacting the Northern Nigeria Personal Tax Law. The Federal Capital Territory was not left out as the federal parliament, in 1961, enacted a law known as Personal Income Tax (Lagos) Act which applied to the territory. This Act repealed the Income Tax Ordinance of 1943.

In 1970, Lagos State posed an edict which adopted the Federal Government Personal Income Tax (Lagos) Law Amendment Edict of 1968. This edict of 1968 which was made to apply to the whole States had only been applied in the city of Lagos.

An attempt was made to harmonize all the taxes in the federation by enacting the Income Tax Management Act of 1961 which addressed certain issues such as the determination of residence, chargeable income, and taxation of partnership and so on, but it did not fix a uniform tax rate, allowances and relief for the country. The establishment of the Joint Tax Board by the Income Tax Management Act of 1961 was another attempt to harmonize all the taxes in the country but unfortunately the Board could not do so.

On 17th February 1975, the Federal Military Government took a bold step towards the harmonization of the tax rates, allowances and reliefs throughout the country by promulgating the Income Tax Management (Uniform Taxation Provisions) Decree No. 7 of 1975 which amended the Income Tax Management Act of 1961 and the Income Tax (Armed Forces and other Persons) (Special Provisions) Decree No. 51 of 1972. This Decree No. 7 of 1975 provided for a uniform taxation in respect of Personal Income Tax. It unified all rates, reliefs and allowances throughout the country. The Income Tax Management Act of 1961 was amended several times until it was repealed by the Personal Income Tax Decree of 1993. This Decree also repealed the Income Tax (Armed Forces and other Persons) (Special Provisions) Decree No.51 of 1972. The Personal Income Tax Decree of 1993 is still in force with the following amendments Decree 30, 31 and 32 of 1996; Decree 18 and 19 of 1998; Decree 30 of 1999 and PIT Amendment Act No. 20 of 2011.

Personal income refers to income of individuals, communities, families etc. arising from employment, business, trade, vocation, profession etc. Personal income is subject to tax based on the provision of Personal Income Tax Act (PITA) 1993 as amended to date. Personal income tax in Nigeria covers areas such as:

(a) Taxation of Sole Trader

(b) Taxation of Employees (PAYE)

(c) Taxation of Partnership

Taxation of Settlements, Trusts and Estates.

The various sources of income on which tax is payable are as follows:

i. Gains or profit of any trade, business, profession or vocation, these incomes are usually assessable to tax on preceding year basis.

ii. Remuneration of an employment, including sums paid to the employee, such as salaries, wages, allowances and other benefits in kind. They are usually assessable to tax on Actual Year Basis (AYB).

iii. Gains or profits including premium arising from the grant of the right of use or exploration of assets such as Royalties, Rent, Patent, Premium etc. These incomes are usually assessable to tax on Preceding Year Basis (PYB).

iv. Income from investment. Such as dividends and interest. These incomes are assessable to tax on Preceding Year Basis (PYB).

v. Income from previous employment by way of pension. This is treated like employment income and assessable to tax on Actual Year Basis (AYB)

vi. Any other income not included above such as lottery winnings, gambling, betting etc. provided the income has not been derived through criminal means.

3.03 Determination of Residence and Relevant Tax Authority

The residence of a tax payer is a key factor in determining the relevant tax authority that his tax will be paid to. The first schedule of the personal income tax decree describes 'a place of residence' in relation to an individual as "a place available for his domestic use in Nigeria (on a relevant day) and does not include any hotel, rest-house or other place for which he is temporarily lodging unless not one permanent place is available for use on that day".

Principal Place of Residence

A Principal Place of residence is determined where an individual has more than one place of residence on a relevant day. Principal place of residence in relation to an individual with two or more places of residence on a relevant day, not being both within any one territory, means;

(a) In the case of individual whose only earned income is pension in Nigeria, that place or those places in which he usually resides.

(b) In the case of an individual who has a source of earned income other than a pension in Nigeria, that place which is nearest to his usual place of work. Earned income in relation to an individual means income derived by him from a trade, business, profession, vocation or employment carried on or exercised by him and a pension derived by him in respect of any previous employment.

(c) In the case of an individual, who has a source or sources of unearned income in Nigeria, that place or those places in which he usually resides.

The PITD (1993) stipulates conditions of residence in Nigeria as follows:

1. **Foreign Employment:** This means any employment, where the duties of which are wholly performed outside Nigeria, apart from any temporary visit of the employee to Nigeria. An individual who holds a foreign employment on the first day of a year of assessment (or who first becomes liable to income tax in Nigeria for that year by reason of his entering such employment during that year), is deemed to be resident in that year in the territory in which the main or principal office of his employer is situated.

2. **Nigerian Employment:** This means any employment, other than foreign employment, where the duties are wholly or partly performed in Nigeria. An individual who holds a Nigerian employment (or who first becomes liable to income tax in Nigeria for that year by reason of his entering such employment during that year) is deemed to be resident in the territory in which he has a place or principal place of resident on that day. Where an individual is on leave from a Nigerian employment on the first day of a year of assessment he is deemed to be resident for that year by reference to his place or principal place of resident immediately before his leave began.

3. **Other Employment:** An employee whose remuneration is subject to income tax in Nigeria but whose residence cannot be determined under Nigerian employment is deemed to hold a foreign employment. If however, his residence cannot be determined under foreign employment, then he is deemed to be resident in the Federal Capital Territory.

4. **Trades, Business, Profession or Vocation:** Where an individual has no place or principal place of residence in Nigeria, he is deemed to be resident in the state where his income is derived. If he derives his income from more than one State then he is deemed to be resident in the Federal Capital Territory.

Basic Terms

i. **Earned Income:** PITA defines earned income in relation to an individual, as "income derived by him from trade, business, profession, vocation or employment carried on or exercised by him and the pension derived by him in respect of a previous employment.

ii. **Unearned Income:** Unearned income is defined in PITA as the income derived from sources other than trade, profession, business, vocation, employment or any reward for services rendered. Examples of unearned income are dividends, interests, rent and so on. These types of income are usually derived from investment and property.

iii. **Year of Assessment (YOA):** This is otherwise called the tax year which is the government financial year. Prior to 1980 tax year, the period starts from 1st April and ends 31st March. After 1980 tax year to date, the year of assessment runs from 1st January to 31st December of each year.

iv. **Accounting Period:** This is the period for which a tax payer has declared his state of business in the preceding year or otherwise.

v. **Basis Period:** This is the period where a tax payer is assessed to tax, for any year of assessment under consideration.

vi. **Preceding Year Basis (PYB) of Assessment:** This is a basis where the income of the accounting period ending in the preceding year of assessment is, being assessed to tax.

vii. **Actual Year Basis (AYB) of Assessment:** This is the basis where the income of the actual year of assessment or tax year under consideration is being assessed to tax in the same year.

3.04 Reliefs and Allowances Available to an Individual

The following reliefs and allowances may be claimed by an individual under the provisions of the Personal Income Tax Act, 1993 as amended up to 13th June, 2011.

Personal Allowance

This is an allowance granted to any tax payer that has a source of income. From 1992-1997 at N3000 + 15% of earned income with effect from 1998 - 2011, it is at N5,000 plus 20% of earned income. This can be claimed by all tax payers.

Children Allowance

This allowance is granted to tax payers who during the preceding year maintained a natural off-spring or an adopted child. It is to be claimed at N2,500 per annum per child up to a maximum of four children. For the claim to be successful, the following conditions must be met:

- The child must not exceed the age of sixteen.

- The child must be unemployed.
- Where the child exceeds the age of sixteen years, he must either be an apprentice to a trade or he must be attending a full-time education.
- The child needs not belong to the tax payer.

Successful rates

1992-1994 YOA	N500 per annum per child subject to maximum of four children
1995-YOA	N1000 per annum per child subject to maximum of four children
1996-1997 YOA	N1,500 per annum per child subject to maximum of four children
1998-2011 YOA	N2,500 per annum per child subject to maximum of four children

Dependent Relative Allowance

This is granted to tax payer in respect of dependents maintained by him. Dependents are aged parents of the tax payer or the spouse. It also includes close relatives who are incapacitated by age, infirmity or contracted by a disease. Up to 1994 YOA it is N600 per annum per tax payer; 1995 to 1997 YOA it isN1000 per annum per taxpayer. With effect from 1998-2011 YOA, it is to be claimed at N2,000 per annum per dependent relative for a maximum of two dependents. For the claim to be successful, the dependent's annual income should not exceed N2000 per annum.

Life Assurance Policy Allowance

This is claimed on a life policy taken on the tax payer's life or the life of his spouse.

The amount of the allowance was:

Up to 1994 Tax Year maximum of N2,000

1994-1995 Tax Year maximum of N5,000

The relief to be granted shall be the lowest of:

- The actual premium paid plus any pension fund contribution
- 10% of capital sum assured, or

- 20% of statutory total income.

Disabled Persons Allowance

This is available to a disabled person who uses special equipment or engages the services of an attendant in the course of paid employment. The rate allowed is the higher of 20% of the earned income or N3,000 per annum. The taxpayer must use special equipment with the service of an attendant.

Note: This is not an alternative to personal allowance, but an addition.

Investment in Research & Development Company

Where an individual invests in the equity of a Research and Development Company he is entitled to allowance which shall be the lower of:

- The actual value of investment, or
- 25% of the total income

Where the allowance claimed in any year is less than the actual investment, the balance shall be carried forward indefinitely until the investment is recouped against income.

Donation to Research and Development Company Allowance

Where an individual makes a donation to a research and development company, he will be entitled to an allowance which shall be the lower of

- The actual donation made, or
- 10% of the chargeable income.

Where the allowance claimed is lower than the actual donation, and the balance is lost because it cannot be carried forward.

Subject to 14th June, 2011 amendment, Section 33 (Personal Relief) is amended to provide for Consolidated Relief and Allowance. It provides that “there shall be allowed a consolidated relief allowance of N200,000:00 subject to a minimum of 1 percent of gross income whichever is higher plus 20 percent of the gross income and the balance shall be taxable in accordance with the Income Tax Table in the Sixth Schedule to this Act."

3.05 Table of Personal Income Tax Rate

From 1998 to 2000	From 2001 to 2011	From 2011 to date
First N20,000 at 5%	First N30,000 at 5%	First N300,000 at 7%
Next N20,000 at 10%	Next N30,000 at 10%	Next N300,000 at 11%
Next N40,000 at 15%	Next N50,000 at 15%	Next N500,000 at 15%
Next N40,000 at 20%	Next N50,000 at 20%	Next N500,000 at 19%
Above N120,000 at 25%	Above N160,000 at 25%	Next N1,600,000 at 21%

Above N3, 200,000 at 24%

3.06 Taxation of Sole Traders

A sole trader is assessed to tax on preceding year basis. A sole trader is an entrepreneur i.e. the owner of a business. For tax purposes, a sole trader includes an architect who runs a studio, a trader in the market and a lawyer who runs a firm etc. In the process of enhancing the tax liability of a sole trader, the financial statements (accounts) presented to tax authority must be critically examined in order to ascertain whether or not the expenses deducted or income is admitted for tax purpose (allowable or disallowable).

In determining whether or not an expense is to be admitted for tax purpose, it must be wholly, reasonably, exclusively and necessarily incurred for the purpose of the business. An income must also be admissible for tax purpose. Taxable income previously omitted by the sole trader must be included for tax purpose.

Wholly: This suggests that an expense to be deducted must have been incurred solely for the purpose of the business.

Reasonably: This means that the expense must be reasonable, relative to the totality of the financial statement; the expenses must not be outrageous.

Exclusively: This is very similar to the concept of ‘Wholly’ it only suggests further that the expense must be exclusive for the business.

Necessarily: This means that the expense must be necessary for the purpose of generating income for the business.

However, there are some expenses that are allowed for tax purpose, while some are disallowed.

Allowable Expenses

1. Any interest on a loan obtained for the purpose of the business.
2. Bad debt written off in the course of a trade or business.
3. Specific provision for doubtful debts.
4. Rent and premium in respect of land and building occupied for the purpose of the business.
5. Contribution to an approved pension fund by Joint Tax Board.
6. Legal expense.
   i. Renewal of short term lease.
   ii. Retainer fee.
   iii. Cost of protecting or defending the business.
   iv. General legal advisory services.
7. Rent of accommodation for the staff provided it does not exceed the annual basic salary of the staff.
8. Repair expenses on fixed assets and renewal of implementation or part.
9. Donations to institution or organization listed in the CITA' 79 provided:
   i. The donation was made out of profit.
   ii. It must not be of valuable consideration.
   iii. It must not be of a capital nature.
   iv. It must not be more than 10% of total profit before the donation.
10. Any other expense that is wholly, reasonably, exclusively and necessarily incurred for the purpose of the business.
11. Subscriptions to organizations related to the business.

12. Accountancy fees & auditors remuneration.

Disallowable Expenses

1. Depreciation of fixed assets.
2. Any private or personal expenses
3. Expenditure of a capital nature.
4. General provision for doubtful debt.
5. Fines and penalties.
6. Income tax provision.
7. Any withdrawal of capital.
8. Donation to unapproved bodies.
9. Any contribution to unapproved pension fund.
10. Any sum reserved out of profit or appropriations.
11. Any sum recoverable under an insurance scheme.
12. Legal expenses:
    - i. Cost of acquiring a new lease, either long or short term lease.
    - ii. Cost of renewing a long term lease.
    - iii. Cost of defending a tax appeal.
    - iv. Cost of defending traffic offense.

1.3 Cost of tax appeals.

14. Capital withdrawn or repaid.

15. Loss on disposal of asset.

Format for Computing Tax Liability of Sole trader

	N	N
Net profit/loss		xx
Add disallowable expense	xx	
Taxable income omitted	xx	xx
Deduct-Non-taxable income included	xx	
Allowable expenses not recorded	xx	(xx)
Adjusted profit		xxx
Add balancing charge		xx
Loss b/f	xx	
Loss for the year	xx	(xx)
Relieved loss	(xx)	
Loss c/f	xx	
Assessable profit		xxx
Capital allowance b/f	xx	
Capital allowance for the year	xx	
Relieved capital allowance	(xx)	(xx)
Capital allowance c/f	xx	
Taxable profit		xx

Earned Income:		**N**	**N**
Taxable business profit		x	
Other earned income	x		

Total earned income		xx	
Unearned Income:			
Dividend	x		
Interest	x		
Rent	x		xx
Total Income		xxx	
Deduct:			
Personal Allowance	x		
Children Allowance	x		
Dependent Relative Allowance	x		
Life Assurance Allowance	x		
Donation to R&D Allowance	x		xx
Chargeable profit			xxx

Apply the table of personal income tax rates.

The new law calls for adjustment of reliefs and allowances to consolidated relief and allowance as per PIT Section 33 of 2011 amendment. "There shall allow a consolidation relief allowance of N200,000.00 subject to a minimum of 1% of gross income whichever is higher plus 20% of gross income and the balance shall be taxable in accordance with the Income table in the sixth schedule to this Act".

3.07 Taxation of Employees

Employees are generally assessed to tax on the basis of Pay As You Earn (PAYE). The tax payable by an employee is determined on Actual Year Basis (AYB) through the process of Pay As You Earn (PAYE).

PAYE Scheme

This is a method of collecting tax due on employment income. The employer is required to deduct tax on all employment income, such as salaries and wages, bonuses, allowances and other benefits in kind. The employer is an unpaid agent of the tax authority. Failure to deduct tax by the employer will attract penalty at 10% and interest at the ruling commercial rate.

Procedure for Operating PAYE

At the beginning of the year, every employee is expected to complete Form A i.e. form for the return of income and claim for allowance and reliefs. The forms will then be examined by a responsible official of the company. To ensure that the information contain therein are correct. The forms are then forwarded to the related tax authority, which also examine the forms and use them in computing the reliefs and allowances due to each employee. The reliefs are then entered in a tax deduction card. The figures on the cards would have been arrived at by dividing the total allowances due to such employee by twelve. The deduction cards together with notice of total amount payable and related allowances are then forwarded to the employer, to be used in computing the tax due from each employee each month of the year.

The total tax deducted less total of all refunds must be remitted to the relevant tax authority, through a designated bank within two weeks after the end of the month. Failing to do so, will attract penalty and interest at the appropriate rate as stated above. This process by 2011 amendment demands for consolidated reliefs and allowances.

Employees Leaving

Where an employee leaves an employment before the end of the tax year, the employer is expected to complete the employee tax deduction card up to the date of leaving and terminal remuneration paid must be stated on the card. The card would be marked “self”, while the date of leaving will be noted thereon and held to the end of the tax year. The employer will be required to complete a transfer certificate which will be forwarded to the revenue authority immediately and a copy will be handed over to the employee to be presented to the new employer if any.

Where an employee dies:

Transfer certificate will be prepared in respect of the employees and copies forwarded to revenue authority.

New Employee

Where an employee is newly engaged, he will be required to present the transfer certificate from his previous employer if any. Where he has no previous employment, a tax deduction card will have to be obtained for the employee.

End of Year Procedure

At the end of the year, every employer is required to file a return to the tax office in the prescribed manner using the employer's annual declaration form (Form H) which discloses information on the name of the employee, gross pay, and tax deducted and tax remitted. The Form H together with the remittance card (Form G) and all tax deduction cards used during the year, must be submitted to the relevant tax authority within 30 days after the end of the year. After the returns have been filed, the employer can then apply for tax clearance certificate using form 2 Information relating to last 3 years is disclosed on the amount of income and tax paid.

Employer's Liability

Any employer who fails to operate the PAYE's scheme in the prescribed manner by deducting tax from employees pay, shall be liable to make restitution, and might be charged penalty for:

1. Failure to deduct tax from employees pay.
2. Failure to remit tax deducted.
3. Failure to disclose the correct number of employees and their pay.

Sources of Employment Income

The following are the sources of employment income and the treatment for tax purpose:

(i) Basic salaries.

(ii) Housing allowance.

(iii) Transport allowance.

(iv) Utility allowance.

(v) Entertainment allowance.

(vi) Leave allowance.

(vii) Meal allowance.

In recent development, they are all presented as consolidated salaries.

Basic Salary

This is fully subjected to tax for the period the employee is in service for a particular tax year. When an employee is not in employment for the full year, basic salary will be pro-rated to reflect such period. Salaries are subjected to tax when due and not necessarily when received.

Housing Allowance

This would be exempted from tax if the amount received does not exceed N150,000 per annum. Where the amount received by way of housing allowance is more than N150,000, the surplus will be subjected to tax in the hands of the employee. This applies up to 2011 YOA.

Transport Allowance

This is exempted from tax if the amount received does not exceed N20,000 per annum, where the amount received is in excess of N20,000, the difference is subjected to tax in the hands of the employee up to 2011 YOA.

Utility Allowance

This is exempted from tax provided the amount received by an employee does not exceed N10,000 per annum if the amount received is in excess of N10,000 per annum, the differences is subjected to tax up to 2011 YOA.

Entertainment Allowance

An employee who is paid entertainment allowance that does not exceed N6,000 per annum is exempted from tax on this income. Where the amount received exceeds N6,000 per annum however the difference is subjected to tax.

Leave Allowance

Leave allowance received by an employee will be exempted from tax if the amount received does not exceed 10% of the basic salary. Any amount received in excess of this would be charged to tax in his hands.

Meal Allowance

This is exempted from tax if the amount received does not exceed N5,000 per month. Where the amount received is in excess of N5,000, the excess will be subjected to tax.

Bonus& Commission

Where an employee is paid bonuses and/or commission this would be fully charged to tax in his hands. It must be noted however that tax will arise when the bonus or commission is received.

Overtime Allowance

This is fully chargeable to tax. This is because the overtime is treated as part of the salary or wage.

Benefit-in-Kind

These are expenses incurred by the employer for the benefit of the employees. There are two categories of such benefits:

(i) Use of assets owned by the employer: Where an employer provides an employee with any assets for use in his employment, the employee will be deemed to be in receipt of additional income per annum equal to 5% of the cost of the asset if known or 5% of the market value at the date of acquisition.

(ii) Use of asset where an employer provides an employee with any asset for which the employer pays a hire or rental charge. The employee will be deemed to be in receipt of additional income equal to the annual amount expended by the employer in providing such benefits, such as: motor car, house etc.

The entire reliefs and allowances granted to tax payers and processes were before 14th June, 2011.

Format for Computing Tax Payable by an Employee

	N	N
Earned Income:	x	
Basic Salary	x	
Housing Allowance	x	

Pension Income		x		
Leave Allowance		x		
Total Employment Income		xx		
Other earned income		x		xx
Unearned Income:				
Dividend		x		
Interest		x		
Rent		x		xx
Statutory Total Income				xxx
Less: General charges			(xx)	
Net statutory Income			xxx	
Deduct:				
Personal Allowance		x		
Children Allowance		x		
Dependent Relative Allowance		x		
Assurance Policy Allowance	x			
Donation R & D Allowance	x			
Investment in R & D Allowance		x		(xx)
Chargeable income				xx

Apply the table of Personal Income Tax rate.

2011 Amendment

	N	N
Total (Gross) Income		xx
Consolidated Relief and Allowance		
(N200,000 or 1% of Gross Income)		
Whichever is higher +		
20% of Gross Income		(xx)
Less Non-Taxable Income:		
Pension contribution	x	
NHIS	x	
NHF	x	
Gratuity	x	(xx)
Taxable Income		xx

First N300,000 @ 7%

Next N300,000 @11%

Next N500,000 @15%

Next N500,000 @19%

Next N1,600,000 @21%

Over N3,200,000 @24%

3.08 Partnership Assessment

A Partnership is a relationship that subsists between two or more persons in business, with a view to making profit. A partnership as an entity is not liable to tax. It is the partners who make up the partnership that are assessable to tax on the income of the partnership. The partners will be treated like any individual in business. Income derived by partners from the partnership business is assessable to tax on preceding year basis. The profit of a partnership will be adjusted according to the provision of Personal Income Tax Decree (PITA) 104 of 1993.

Partners Income Subject to Tax

PITA, 1993 stipulates that the income of a partner from the partnership shall constitute the following:

(i) Salary or remuneration paid to partners.

(ii) Interest on capital.

(iii) Interest on loan.

(iv) Cost of passage to or from Nigeria for leave or revenue incurred by the partnership or a partner.

(v) Other personal expenses incurred on a partner.

(vi) Share of partnership profit in the agreed profit sharing ratio.

For an on-going partnership, the divisible income of the partnership will be arrived at by deducting capital allowance from assessable profit.

Changes in the Composition of a Partnership

Admission of a Partner:

Where a new partner is admitted, technically the old partnership would have come to an end and a new one commences, however, because a partnership is not a taxable entity, it is the new partner who is deemed to have commenced new trade. The provision for the commencement of a new business will be applied on the income of an incoming partner. The old partners will be assessed on preceding year basis.

Retirement of a Partner:

Where a partner retires, the retiring partner is deemed to have ceased a trade and the rules for cessation of a trade would be applied on the income of the retiring partners. The old partners' income will be applied as follows.

(i) Split the profit of the accounting period. i.e. period before retirement or admission and period after retirement or admission.

(ii) Share the profit for each of the relevant periods among the partners who were in business during the period.

(iii) Aggregate the income of all partners from each of the relevant period.

(iv) Apply the relevant basis of assessment i.e.

a. For retiring partner, cessation rule.

b. For new or incoming partner, commencement rule.

c. For continuing partners, preceding year basis.

Commencement or Cessation for a Partner

Where a partner joins a new partnership from another partnership who are in the same type of business as the old partnership, the rule for the commencement and cessation of a trade would not be applied on the partner.

Capital Allowance

The relevant tax authority in respect of the partners is the tax authority of the territory where the principal office or place of business of the partnership is located on the first day in that year of assessment. Where a partner is liable to tax to another authority; that relevant tax authority shall supply that other authority with information on the income derived by that partner from the partnership.

Conversion of a Partnership Business to a Limited Liability Company

Where a partnership business is converted to a limited company, the following are the tax implications:

(i) In respect of assessable profit, the partnership business is deemed to have come to an end and the rules for the cessation of a trade would be applied on the income of each of the partners. The limited liability would be deemed to have commenced a new trade and the rules for the commencement of a new business would be applied on the income of the limited liability company.

(ii) In respect of capital allowance, the qualifying capital expenditure of the partnership will be deemed to be transferred to the company, at their Tax Written Down Value (TWDV), especially where such transfer has not been made at arm's length. Where the transfer is made at arm's length, the asset would be deemed to have been transferred at arm's length value. However, in both situations, the limited liability company will not be entitled to initial allowance claim on the assets only annual allowance will be granted. Note that balancing charge, balancing allowance and capital gains may result on such transfers.

Procedure for Computing Chargeable Income of Partners

1. Identify the net profit or loss of the partnership.
2. Add non-allowable expenses and taxable income not previously reported.
3. Deduct non-taxable income and allowable expenses not previously deducted.
4. The addition of steps 1 to 3 results in adjusted profit or loss.
5. Deduct all private expenditure and transfer to each partner including salaries, interest on capital and leave passages.
6. Whatever is left is then shared in the agreed profit and loss sharing ratio.
7. Sum up the amount due to each partner.
8. Deduct losses attributable to each partner from the partners' income.
9. Share the capital allowance of the partnership in the agreed profit or loss sharing ratio.
10. Deduct the capital allowance from the partners' income.
11. Add any other income(s) earned by each partner to his partnership income.
12. Deduct all personal relief available to each partner.
13. Compute tax liability.

Format I: Income Derived by a Partner from Partnership

	A	B	C	TOTAL
Divisible Income				xx

Share of profit (**PSR)**	x	x	(xx)	
Salaries	x	x	x	Nil
Cost of passage	x	x	x	
Interest on capital	x	x	x	
Other expenses on partners	x	x	x	
Total income to partners	xx	xx	xx	
Less Reliefs:				
Consolidated Relief and Allow	(x)	(x)	(x)	
Capital allowance	(x)	(x)	(x)	
Dependent relative allowance	(x)	(x)	(x)	
Taxable Income	xx	xx	xx	
Apply Tax Table of rates				

This format assumes that expenses incurred on partners, such as salaries and wages; interest on capital; cost of passage etc. have been charged to profit and loss in arriving at the net profit and not disallowed in determining the adjusted profit.

Format II

	A	**B**	**C**	**TOTAL**
Divisible Income:				xx
Interest on capital	x	x	x	(x)
Cost of passage	x	x	x	(x)
Salaries	x	x	x	(x)

Share of Profit	x	x	x	(x)
Income from Partnership	xx	xx	xx	Nil

This format assumes that expenses incurred on partners such as interest on capital, cost of passages, salaries etc. were not charged in to the P&L account and where they have been charged to P&L account, they must have been disallowed in arriving at the adjusted profit.

3.09 Taxation of Settlement, Trust and Estate

A "Settlement" is an agreement by which a sum of money is set aside to make provision for another person e.g. (a marriage settlement).

A "Trust" is the conveyance of property to one or more persons with the confidence that it would be applied for the benefit of others or for a specific purpose. This arrangement is usually made out in writing establishing a document known as trust deed. Trust deed is a specified terms of arrangement which normally include items like, remuneration of the trustee, fixed charges to be paid by the trust, provisions for discretionary payment and percentage due to the beneficiaries. A trust may be created by will, by deed, or occasionally by an order of the court.

An 'Estate' is the aggregate of assets possessed by a person including his goods, money and property of all kinds at death, his estate passes into the possession of his personal representative, i.e. executor or administrator whose duties are to meet the necessary funeral expenses, obliging to any will, legally proved and to realize the estate and pay debts. They deal with the residue of the estate as directed by the will, if any, or if none, according to the rules of intestacy.

Types of Person that may benefit from Income of an Estate

1. **Legatee:** A legatee is a person receiving specific bequest e.g. (investment) from the estate, i.e. a person to whom a legacy is bequeathed.

2. **Residual Legatee:** This is a person entitled both to income and capital (or part of it) at the end of the administration period. He holds an absolute interest and is known as a 'residuary legatee' or 'residuary devisee'.

3. **Annuitant:** This is a person receiving an annuity which may be charged on the income of the estate or on a particular asset.

4. **Beneficiary:** This is a person that is entitled to income and capital (or part of it). He holds a limited interest at the end of a specified period usually at the death of such a beneficiary, the capital passes to some other persons, the 'remaining'.

(i) **Total Income:** Total income is the aggregate of all sources of income cleared by the settlement trust or estate in any year of assessment.

(ii) **Computed Income:** Computed income of an estate, trust or settlement is the difference between the total income and allowable expenses.

(iii) **Allowable Expenses:** This include authorized payments like the fee payable to the trustee, legacy annuity, but excluding the amount payable to the beneficiaries.

(iv) **Discretionary Payment:** This is the payment that is usually made at the discretion of the trustee or executor. It is fixed and payable annually. Any amount received as discretionary payment by a beneficiary is chargeable to tax in his hand.

(v) **Distributions to Beneficiaries:** After the deduction of discretionary payments from computed income, distributions are made to beneficiaries from the balance thereof; such payment is termed distribution to beneficiaries. Amount distributed to a beneficiary is chargeable to tax in his hand.

(vi) **Loss Treatment:** Any loss incurred by the settlement, trust or estate is available for relief against the profit of subsequent years of assessment. However where a loss is transferred to the settlement, trust or estate such a loss is not available for relief.

(vii) **Capital Allowance:** For assets transferred to the settlement, trust or estate, it is assumed to be transferred at the tax written down value.

(viii) **Initial Allowance:** It is not to be claimed on transferred assets. Annual allowance claimable shall be based on the un-expired life of the transferred assets.

(ix) If any of the assets transferred is later disposed, any balancing adjustment to be determined should be computed with reference to the total allowance previously granted to both the transferor and the settlement trust or Estate.

Tax Payable by Trustee

After the distribution of a portion of the remainder of computed income to the beneficiaries, any undistributed balance is deemed to be the trustee's income, consequently, the income is being charged to tax in the hands of the trustee.

Procedure for computing chargeable income of a beneficiary

(i) Identify all the sources of income of the settlement, trust and estate.

(ii) Sum up the income to obtain the total income.

(iii) Identify all the allowable expenses.

(iv) Determine the computed income by deducting the allowable expenses from the computed income.

(v) Deduct discretionary payment to beneficiaries from step (iv) above.

(vi) Allocate amount distributed to each beneficiary based on the trust deed.

(vii) The chargeable income of each beneficiary from the settlement, trust or estate is the sum total of individual's discretionary payment and distributions.

Format for Determining Chargeable Income

	N	N
Income		
Interest	x	
Rent	x	
Dividend	x	
Trading Profit	x	
Sundry Income	x	
Total income		xx
Deduct Expenses		
Trustee Remuneration	x	

Trustee Annuity	x	
Specific Legatee	x	
Residual Legatee	x	
Administration Expenses	x	
Authorized Payment	x	(xx)
Computed Income		xxx
Less:		
Discretionary Payment		
A	x	
B	x	(xx)
Remainder of computed Income		xx
Distribution to beneficiaries		
A	x	
B	x	(xx)
Trustee Income Taxable		xx

Income of beneficiaries

	A	B
	N	N
Discretionary Payment	x	x
Distribution	x	x
	xx	xx

3.10 SPECIFIC EXPENDITURE AND THEIR TREATMENTS

S/N	ITEM OF EXPENDITURE	TREATMENT	REMARK
1.	Preliminary expense	Disallowed	Capital in nature
2.	Formation expense	Disallowed	Capital in nature
3.	Legal expense:		
	- Court	Disallowed	Capital in nature
	- Incorporation	Disallowed	Capital in nature
	- Traffic offence	Disallowed	Not WREN
	- Retainership		
	(service of professional)	Allowed	Revenue items
	- Feasibility study	Disallowed	Capital in nature
	- Lease	See Note 1	See Note 1
	- Increase in Share Capital	Disallowed	Capital in nature
	- Stamp Duties	See Note 2	See Note 2
	- Debts recovery	Allowed	Revenue Item
	- Penalty/fine	Disallowed	Not WREN
4.	Defending title to property	Disallowed	Not WREN
5.	Improvement	Disallowed	Capital Item
6.	Demarcation	Disallowed	Capital Item
7.	Partitioning	Disallowed	Capital Item
8.	Enhancement	Disallowed	Capital Item
9.	Construction	Disallowed	Capital Item
10.	Repair and maintenance	Allowed	Revenue item

11.	Removal {Shifting base}	See Note 3	See Note 3
12.	Salaries/wages	Allowed	Revenue item
13.	Donations/subscription	Allowed	Subject to Approve List
14.	Bad debt	Allowed	See Note 5
15.	Telephone/Telex/Telegraph	Allowed	Revenue Item
16.	Custom and excise duty	Allowed	Revenue Item
17.	Superannuation fund		
	scheme See	Allowed	See Note 6
	e.g. NPF {NSITF} Pension scheme		
	ITF {Industrial Training Fund}		
18.	Traveling Expenses	Allowed	See Note 7
	Rent and Rates		
19.	Entertainment	Allowed	Revenue Item
20.		Allowed	See Note 8
21.		Allowed	WREN
		{if it is necessary for the business}	
	Advertising		
		Allowable	
	Public Relation		
		Allowable	
22.	Depreciation {Amortization}		See 9
		Disallowed	
23.	Profit or loss on sale of Fixed assets		See 10
		Profit not	
24.			Capital Item
		Chargeable	
25.			Capital Item
		Loss not	
	Profit or loss on Revaluation		

		allowed	
	Profit or loss on Investment	{Same as in 25 above}	
26.			
	Profit or loss on Intern company balance	{Same as in 25 above}	
27.			
	Profit or loss on Remittances (Forex transaction)	{Same as in 25 above}	
28.		Profit	
		Chargeable;	
	Audit/Accounting fees		
29.		Loss Allowed.	Revenue Item
	Management/Technical fees		
		Allowable	
	Professional fees		
		Allowable	
	Director fees		
30.		Allowable	Revenue Item
	Medical fees		
31.		Allowable	See Note 11
	Bank charges		
32.		Allowable	Revenue item
	Interest charges		
33.		Allowable	See Note 12
	Research and Development (R & D)		
34.		Allowable	Revenue Item
	Electricity fees		
35.		Allowable	Revenue Item
	Newspaper/Journals		
36.			Revenue Item
	Taxes		
37.		Allowable	By statute
		Allowable	
38.		Disallowed	Revenue Item
39.			See Note 13
40.			See Note 14

Note

1. Lease: Lease is of two types and short lease. Any legal expenses on either long or short lease will be disallowed. Retainership of a long lease will also be disallowed, but retainership on a short lease will be allowed.

2. Stamp duties: stamp duties on increase in share capital area always disallowed. Other stamp duties are allowed.

3. Removal/alterations: It should be allowed if it is of revenue in nature and disallowed if of capital in nature.

4. Donations/subscriptions: for donations to be allowed for tax purposes, the following conditions must prevail.

   - The donation must have been made to one of the bodies under schedule 5 of CITA or as approved by the SBIR

   - The donation must not be of capital in nature

   - The donation must not be made out of loss

   - The donation must not exceed 10% of the profit before the deduction of such donation.

For subscription to be allowed for tax purposes it must be necessary for the purpose of the trade or business e.g. subscription of manufacturing companies to manufacturing associations, accounting firms to ICAN etc.

5. Bad and doubtful debts: General provisions for bad debts are always disallowed. Bad debts recovered are always chargeable to tax. More so, if a company is in the business of money lending, loans to staff written off will be allowed for tax purposes.

6. Superannuation fund scheme: NPF and pension scheme are allowed subject to the limit set or approved by the JTB

7. ITF: This will be allowed if approved by the JTB

8. Rent and Rates: This will be allowed for tax purposes, subject to the restrictions of the Act.

9. Advertising: Advertising of consumables in nature will be allowed for tax purposes. Examples are advert in newspapers, journals, radio, TV. But advertising of a capital in nature will be disallowed e.g. Advert on neon Sign Post and Sign Boards which could stay for a long time based on maintenance.

10. Public Relation: Expenditure on public relations will be allowed if they are promotional in nature (mostly cost on it is kept on a reasonable level as it is mostly disallowed).

11. Management/Technical Fees: This will allowed if approved by the minister of finance.

12. Directors fees: Directors fees are generally allowed, but where it involves holding company, N3,000 will only be allowed for 2 directors. But if no holding company is involved it will be allowed.

13. Newspaper/Journals: They will only be allowed if they are necessary for the business for conventional papers (such as Punch, Concord, Tribune etc.) and specific Journals which relate to the business (e.g. for a company in a medical industry, a health journal) is allowed.

14. Taxes: are disallowed in whatever form

3.11 Review Questions

Question I

Mr. Kolo is a staff of NEXIM Bank Plc with a consolidated monthly salary of N784,261. In addition, he receives N396,000 per month for his accommodation.

He receives additional income on the following:

Year		Source	
	Trading	Dividend	Rent
	N	N	N
2010	9,308,652	900,000	1,500,000
2011	6,500,000	705,000	1,500,000
2012	12,800,000	840,000	1,500,000

Note: All dividend and rent are reported gross.

Required: Determine Mr. Kolo's tax liability for 2012 year of assessment.

Solution I

Mr. Kolo

Determination of Tax Liability for 2012 Year of Assessment

	N	N
Earned Income:		
Salaries (784,261 x 12)	9,411,132	
Accommodation (396,000 x 12)	4,752,000	
Trading	6,500,000	20,663,132
Unearned Income:		
Dividend	705,000	
Rent	1,500,000	2,205,000
Gross Income (GI)		22,868,132
Relief & Allowances:		
Consolidated Relief		
(200,000 or 1% of GI) + 20% of GI		
whichever is higher		
228,681 + 4,573,626		(4,802,307)
Chargeable Income		18,065,825
Less Frank Investment		(705,000)
Taxable Income		17,360,825

Tax liability

1st	300,000 @ 7%	=	21,000.00
Next	300,000 @ 11%	=	33,000.00
Next	500,000@ 15%	=	75,000.00
Next	500,000@19%	=	95,000.00
Next	1,600,000 @21%	=	336,000.00
Next	14,160,825 @24%	=	3,398,597.90
			N3,958,597.90
Less Advance Tax credit(Rent)			150,000.00
Tax Payable			N3,808,597.90

Questions II

Mr. Okoronko was retired from the public service of the federal government on 31st March 2006. He then secured employment with a public limited liability company based in Lagos, effective 1st April 2006 as managing director. The following information has been provided by Mr. Okoro.

(a) Salary-from old employment is N20,000 per month, new employment N300,000 per annum.

(b) Pension income effective 1/4/06 N60,000 p.a.

(c) Transport allowance new employment N24,000 p.a .

(d) Rent allowance by new employer N100,000 p.a .

(e) Entertainment allowance is N2,000 per month.

(f) Dividends received (Gross) N

a.	Paid 3/3/05	9,625
b.	Paid 7/8/05	8,415

c. Paid 26/2/06 4,800

d. Paid 20/8/06 6,000

e. Paid 2/12/06 7,200

(g) Rent collected (gross) 1/7/05-30/6/06 N84,040

(h) Expenses on property		N
- Water rate		1,500
- General rate		2,750
- Repairs	2,500	
- Insurance	4,800	
- Interest on Loan	650	

(i) Mr Okoro is married and has five children aged between 4 years and 18 years. All except one, named Kuta-aged 18 are still in school. Kuta is however unemployed.

(j) Capital allowance on building has been agreed with the Revenue at N16,000.

(k) Mr. Okoro has a life assurance policy on Kuta-with sum assured of N200,000 and annual premium of N20,000.

(l) His widowed mother lives with him and he spends N18,000 per annum maintaining her. Although she has an investment income of N12,000 per annum of her own.

(m) Other expenses-Donation to disabled persons N5,000.

(n) His new employer also provided him with a car (costing N350,000) for his exclusive use.

You are required to compute the income tax payable by Mr. Okoro for 2006 year of assessment.

Solution II

Mr. Okoronko

Computation of Income Tax Liability for 2006 Year of Assessment

	Notes	N	N
Earned Income			
Employment Income salary	1	285,000	
- Pension	2	45,000	
- Transport Allowance	3	6,750	
- Entertainment	5	13,500	
- Benefit-in-Kind	8	13,125	363,375
Unearned Income-Rent	6	27,920	
- Dividend	7	18,040	45,960
- Statutory Total Income			409,335
Deduct Relief: Personal Allowance (20% of EI+5,000)		77,675	
- Children Allowance		10,000	
- Dependent Relative Allowance		-	
- Life Assurance Policy Allowance		20,000	107,675
			301,660
Frank Investment (Dividend)			18,040
Taxable Income			293,620

Tax Payable:		N
1st 30,000 at 5%	=	1,500
Next 30,000 at 10%	=	3,000
Next 50,000 at 15%	=	7,500
Next 50,000 at 20%	=	10,000

133,620 at 25%	=	33,405
Chargeable Tax		55,405
Tax Credit (Rent)		(8,404)
Tax Payable		47,001

Working Notes:

1. Salaries

1/1/06-31/03/06 = 20,000 x 3	=		60,000
1/4/06-31/12/06 = 9/12 x 300,000 =		225,000	
			285,000

2. Pension

1/4/06-31/12/06 = 9/12 x 60,000 =45,000

Pension becomes taxable with effect from April 1, 2006

3. Transport Allowance

1/4/06-31/12/06 = 9/12 x (24,000-15,000) = 6,750

Transport allowance is exempted from tax provided it does not exceed N20,000 p.a. from 2001 year of assessment. Any amount in excess of this is charged to tax.

4. Rent Allowance

The rent allowance not exceeding N150,000 per annum is exempted from tax.

5. Entertainment Allowance

1/4/06-31/12/06 = 9/12 = [(2,000 x 12) - 6,000] = 13,500

6. Rental income (1/7/05-30/6/06)

		N	N
Amount collected		84,040	
Less: Water rate	1,500		
General rate	2,750		

Repairs	2,500	
Insurance	4,800	
Interest on loan	650	12,200
Net Income		71,840
Capital allowance		(16,000)
Chargeable Income		55,840
For 2006 year of assessment = 6/12 x 55,840 =		27,920

7. Dividend income:

Since dividend income is charged on the preceding year basis. Only dividend received in 2005 are relevant for the 2006 year of assessment.

	N
Received on 3/3/05	9,625
Received on 7/8/05	8,415
	18,040

8. Benefit–in-Kind

Car = 9/12 x 5% x 350,000 = 13,125

9. He is not entitled to dependent relative allowance because the dependent earns a total income that exceeds N600 per annum.

10. Life assurance policy allowance is claimed as follows:

The lowest of:	N
(a) Annual premium =	20,000
(b) 10% of capital sum assured	20,000
(c) 20% of statutory total Income	66,867

11. The donation to the disabled society is not an allowable deduction.

MODULE 4

4.00 COMPANIES INCOME TAX

4.01 Learning outcome

On successful completion of this Module, Students should be able to:

i. Examine how Companies Income tax is administered and how to deal with the tax authorities in connection with the tax liability;
ii. Evaluate the nature and classification of cost (Allowable or Disallowable) in CITA;
iii. Compute the adjusted profits of companies;
iv. Compute capital allowances for companies for tax purposes;
v. Prepare companies profit for tax computations in accordance with CITA.

4.02 Chargeable Persons

A company is chargeable to tax

(i) In its own name; or

(ii) In the name of any principal officer, attorney, factor, agent or representative of the company in Nigeria; or

(iii) In the name of a receiver or liquidator.

The principal officer or manager of a company shall be held responsible for any tax matter that has to do with his company. This is quite important since every company though a legal person can only act through its management or other responsible staff.

The FIRS in Nigeria has power under the law to appoint any person by notice in writing as agent of any company and the person declared as agent will be required to pay any tax liability of a company for which he is declared as an agent from any money that may be due from him to the company. Such appointed agent cannot refuse or else, the debt shall be recoverable from his own resources. In this regard, any person can be required by the Board to supply details of any funds held by him on behalf of any company. Where a person is appointed as an agent for the payment of tax he is indemnified against any action by any person in respect of such an amount and in the case of a company being wound-up the liquidator of the company cannot distribute any assets of the company to the shareholders unless he has made provision for all tax liabilities of the company including all the taxes the company may have deducted at source and not yet remitted to the tax authorities, this will depend on the provision of liquidation rules.

For instance, a debtor to a company can be asked to give details of his indebtedness to the FIRS after he had been given notice in writing of his appointment as an agent for tax collection from the creditor company.

He would be obliged to supply the details. A demand for the payment of that sum can then be made on him and from that moment, he becomes a tax debtor to the FIRS for that sum in his personal capacity.

4.03 Chargeable Tax

Section 8 of the Companies Income Tax Act provides that tax shall, for each year of assessment, be payable at the rate specified in Section 29 (1) of the Act upon the profits of any company.

- Accruing in, derived from, brought into or received in Nigeria in respect of:

(i) Any annual profit or gains from any other source whatsoever.

(ii) Rent or any premium arising from a right granted to any other person for the use or occupation of any property. Where rent is paid for a Period covering more than one accounting period, the rent shall be treated as accruing proportionately from day to day over the period during which it relates, provided that where the rent is for a period exceeding five years, then it shall be apportioned over a period of five years only.

(iii) Any trade or business for whatever period of time such trade or business may have been carried on.

(iv) Dividends, interest, royalties, discount, charges or annuities.

(v) Any amount of profits or gains from the acquisition and disposal of short term money instruments.

(vi) Any amount deemed to be the income or profit with respect to any benefit arising from a pension or provident fund under the Personal Income Tax Act.

(vii) Fees, dues, allowances when paid for services rendered.

For the purpose of determining chargeable profit, interest is deemed to be derived from Nigeria if:

a. There is a liability for payment of the interest by a Nigerian company regardless of where or in what form the payment is made or

b. The interest accrues to a foreign company or person from a Nigerian company regardless of whichever way the interest may have accrued.

Dividend for the Purpose of Determining Chargeable Profit

a. In relation to a company not being in the process of being wound up or liquidated, any profits distributed whether such profits are of a capital nature or not including an amount equal to the normal value of bonus shares, debentures or securities awarded to the shareholders and

b. In relation to a company that is being wound up or liquidated, any profit distributed whether in money worth or otherwise other than those of a capital nature earned before or during the winding-up or liquidation process.

Company Profit Exempted from Tax

Subject to the provision of Section 19 of CITA, the following profits are exempted from tax:

- The profits of any company being a statutory or registered friendly society, in so far as such profits are not derived from a trade or business carried on by the society.
- The profits of any company being a co-operative society registered under any enactment or law relating to cooperative societies not being profit, from any trade or business carried on with its members or from any shares owned or other interest by some other persons or authority.
- The profit of any company engaged in ecclesiastical, charitable or educational activities of a public character in so far as such profit are not derived from a trade or business carried on by such company
- The profit of any company formed for the purpose of promoting sporting activities where such profits are wholly expendable for such purpose subject to the conditions which the Board may prescribe.
- The profits of any company being a trade union registered under the Trade Union Act in so far as such profits are not derived from a trade or business carried on by such trade union.

- Dividends derived by a company from another company incorporated in Nigeria provided that:

    a. The equity participation of the recipient company, if the company paying the dividend is paid for wholly in foreign currency or by assets brought or imported into Nigeria between 1st January 1987 to 31st December 1992 and

    b. The company receiving the dividend is the beneficial owner of not less than 10% of the equity share capital of the company paying the dividend.

The dividend tax free period shall commence from the year of assessment following that in which the capital was brought into Nigeria for the purpose of the trade or business and continue for a period of five years. For a company engaged in agricultural trade or business. For any other company, the tax free dividend period will be for three years.

- The profit of anybody corporate being a purchasing authority established by an enactment and empowered to acquire any commodity for export in Nigeria from the purchase and sale of that commodity.

- The profits of any company engaged in petroleum operations in so far as the profits are derived from petroleum operations, they are liable to tax under the Petroleum Profit Tax Act.

- The profits of any company being a body corporate established by or under any Local Government Law or Edit in force in any State in Nigeria.

- The profit of any company or any corporation established by the law of a state for the purpose of fostering the economic development of that state not being profits derived from any trade or business carried on by that company or from shares or interest possessed by that company in a trade or business carried on by some other person or authority.

- Dividend, interest, rent, or royalty derived by a company from outside Nigeria and brought into Nigeria through Government approved channels.

- Interest earned on deposit accounts of a foreign non-resident company provided that the deposits into the account are transfers wholly in foreign currencies to Nigeria on or after 1st January 1990 through Government approved channels.

- Dividend received from small companies in the manufacturing sector in the first five years of their operation.

- Dividend received from investments in wholly export oriented businesses.
- Any other company or profits exempted from tax by the order of the National Council of Ministers.
- The profit of a company granted pioneer or by extension from its pioneer operations during the pioneer period or any extension thereof.

4.04 Allowable Expenses

By Section 20 of CITA, the chargeable profit of a company liable to income tax shall be determined after deducting all expenses of the period by that company wholly, exclusively, necessarily and reasonably incurred in the production of those profits, including.

- Any sum payable by way of interest on any money borrowed and employed as capital in acquiring the profits.
- Rent for the period and premiums, the liability of which was incurred during the period in respect of land or building occupied for the purpose of acquiring the profit subject to the case of residential accommodation occupied by employees of the company to a maximum of:

  a. N56,000 per annum for each building and N28,000 per annum for each flat in Lagos area and the Federal Capital Territory of Abuja and

  b. N40,000 per annum for each building and N10,000 per annum for each flat in any other part of Nigeria.

The allowance deductible in respect of rent on staff accommodation is limited to the lower of the actual amount paid or the annual basic salary of the employee occupying the accommodation subject of course to the above limits specified in the Act.

- Any expenses incurred for the repair of premises, plant, machinery or fixtures employed in acquiring the profit or for the renewal, repair or alteration of any implement, utensil or articles so employed.
- Bad debts incurred in the course of the trade or business proved to have become bad during the period for which the profits are being ascertained and doubtful debts to the extent that they are reasonably estimated to the satisfaction of the Board to have become bad during the said period notwithstanding that such bad or doubtful debts were due and payable before the commencement of the said period provided that:

a. Where in any period a deduction under this paragraph is to be made in respect to any particular debts and a deduction in any previous period been allowed in respect of the same debt, the appropriate deduction shall be made in the deduction to be made for the period in question.

b. All sums recovered during the said period on account of previously written off or allowed in respect of bad or doubtful debts shall be deemed to be profit of the trade or business of that period.

c. It is proved to the satisfaction of the Board that the debts in respect of which a deduction is claimed either were included as a receipt of the trade or business in the profit of the year within which they were incurred.

Any contribution to a pension, provident or other retirement benefits funds, society or scheme approved by the Joint Tax Board under the powers conferred upon it by the PITA as amended and subject to any conditions imposed by the Board or any contribution other than a penalty made under the provisions of any enactment establishing a national provident fund or other retirement benefits scheme for employees throughout Nigeria.

Any expenses or part thereof of a trade or business.

a. The liability of which was incurred during that period wholly, exclusively, necessarily and reasonably for the purpose of such trade or business and which is not specifically referable to any period or periods.

b. The liability for which was incurred in any previous period wholly, exclusively, necessarily and reasonably for the purpose of such trade or business and which is specially referable to the period of which the profits are being ascertained.

c. The expenses proved to the satisfaction of the Board to have been incurred by the company on research and development for the period including the amount of levy paid by it to the national Science and Technology Fund.

Any other deduction as may be prescribed by the Minister by any rule.

4.05 Disallowable Expenses

The following deductions are specially disallowed by Section 23 of the Act:

- Any expenses of any description incurred outside Nigeria for and on behalf of any company except of a nature and to the extent that the Board may consider allowable.

- Any payment to a savings, widows and orphans, pensions, provident or other retirement benefit fund society or scheme except as permitted by paragraph (g) of Section 23 of the Act.
- Capital repaid or withdrawn or any expenditure of a capital nature.
- Any sum recoverable under an insurance or contract of indemnity.
- Any amount received out of profits except specific provision for doubtful debts or approved donations.
- Taxes on income or profits levied in Nigeria or elsewhere other than tax levied outside Nigeria on profits which are chargeable to tax in Nigeria where relief for the double taxation of those profits may not be given under any other provision of CITA.
- The depreciation of any asset.
- Expenses of any description incurred within or outside Nigeria for the purpose of earning management fees unless prior approval of the agreement given rise to the fees has been obtained from the minister.

4.06 Deductible Donations

The provisions relating to donations made by a company are contained in Section 21 and the Fifth Schedule of the Act. For any donation to be allowed as a deductible expense the following conditions must be fulfilled.

- The donation must not be an expenditure of a capital nature.
- The donation must be made out of profit. Hence, a donation will not be allowed if it will have the effect of changing an ascertained profit into a loss or increasing the magnitude of an ascertained loss.
- The donation shall not include any outgoing expenses that are allowable deductions under Section 20 of the Act.
- The donation must not exceed 10% of the total profit of the company before deducting the donation.
- The donation must be made to either.

  a. Public funds.

b. Statutory bodies and institutions or

c. Ecclesiastical, charitable, benevolent, educational and scientific Organisations established in Nigeria which are specified in the Fifth Schedule to the Act.

List of Approved Bodies for Donations

- Any hospital owned by the government of the Federation or of a state or any University Teaching Hospital or any hospital which is carried on by the individual members of the society or association.
- The institute of Medical Laboratory Technology.
- The Boys Brigade of Nigeria.
- Any educational institution affiliated under any law with any university in Nigeria, or established under any law in Nigeria and any other educational institution recognized by any government in Nigeria.
- The Boys Scouts of Nigeria.
- The Nigeria Council for Medical Research.
- The Christian Council of Nigeria.
- The Nigerian Institute for Oil Palm Research.
- The Cocoa Research Institute of Nigeria.
- The National Library.
- The Nigerian Red Cross.
- The Nigerian Institute of International Affairs.
- The Girls Guides of Nigeria.
- The Nigerian Museum.
- A public institution or public fund established for the comfort of recreation or welfare of members of the Armed Forces.
- The National Youth Council of Nigeria.

- A public fund established and maintained exclusively for providing money for the acquisition, construction, maintenance or equipment of a building used or to be used as a school or college by the Government of the Federation or a state or by public authority or by a society or association which is carried on otherwise than for the purpose of profit or gain to the individual members of the society or association.
- The National Sports Council or State Association.
- A public established and maintained for providing money for the construction and maintenance of a public memorial relating to the Civil War in Nigeria.
- Rotary International Polio Plus.
- The Nigerian Society for the Deaf and Dumb.
- National Science and Technology Fund.
- The Society for the Blind.
- Education Cooperation Society.
- The Nigerian National Advisory Council for the Blind.
- Paterson Zochonis Nigeria Technical Education Trust Fund.
- The National Association for the Blind in Nigeria.
- Afprint Foundation Limited.
- Training Centers and Residential Schools for the Blind.
- The Kewalram Chanrai Foundation Limited.
- The National Braille Library of Nigeria.
- The Nigerian Accounting Standards Board.
- The Nigerian Youth Trust.
- The Nigerian Conservation Federation.
- Van Leer Nigerian Educational Trust.
- Islamic Education Trust.

- The Institute of Chartered Accountants of Nigeria Building Fund
- Any public fund established or approved by the Government of the Federation or established by any of the State Governments in aid of or for the relief of drought or any other natural disaster in any part of the Federation.

4.07 Offences and Penalties

Most of the offenses in income tax are basic ones. They are identical with the offenses discussed under the personal income tax. The penalties imposed for tax offenses change from time to time. It is therefore advisable to get acquainted with the changes as they occur. The following are some of the offenses and penalties which are for the time being applicable to companies in Nigeria

i. Failure to furnish returns within the stipulated period is punishable on conviction to a fine of N2,500 plus N500 for each month the failure continues.

ii. Where a director, a manager, a secretary, or any servant or agent of a company.

Is found to have connived or encouraged a company in its default to submit returns, such an officer shall have committed an offence punishable on conviction to a fine of N2,000 or imprisonment of six months or both.

iii. False Statement & Returns: Any person other than a company who, for the purpose, of obtaining any deduction, knowingly makes any false statement or false representation or aid, abets, assists, counsel, incites or induces any other person to make or deliver or unlawfully refuses or neglect to pay tax shall be guilty of an offence and shall be liable on conviction to a fine of N1000 or to imprisonment not exceeding 5 years or both.

iv. Offenses by Authorized and Unauthorized persons: Any person who

    a. Being a person appointed for the administration of CITA

i. Demand from any company an amount in excess of the due tax; or

ii. Withhold tax money for his own use; or

iii. Renders a false return of tax money collected by him; or

iv. Uses his position to defraud any person or embezzles any money;

b. Not being authorized under CITA to do so, collects or attempt to collect the tax under the Act shall be guilty of an offence and be liable on conviction to a fine of N600 or to imprisonment for three years or to both such fine and imprisonment.

It is very important to note that the institution of proceedings in respect of any of those offences, or the imposition of penalties, fines and imprisonment does not relieved the company from liability to pay any tax to which it may become liable.

4.08 Ascertainment of Total Profits

As provided for in Section 27 CITA, the total profit of a company for any year of assessment shall be the amount of its total assessable profits from all sources for that year together with any additions to be made in respect of any balancing charge less any deductions to be made or allowed in respect of any losses and capital allowances. Hence the total profit of a company for any year of assessment is ascertained as follows:

	N	N
Assessable Profit		x
Add Balancing Charge		x
		xx
Less: Losses b/forward	x	
Capital allowance	x	
Balancing allowance	x	(x)
Total Profit		xx

Where a company has incurred losses in business, the Board shall allow the loss to be deducted from total assessable profit for any year of assessment following that during which the loss was incurred subject to the following conditions:

(i) In no circumstance shall the aggregate deduction from assessable profit or income in respect of any such loss exceed the amount of the loss.

(ii) A deduction for any particular year of assessment shall not exceed the amount, if any, of the assessable profit, included in the total profits for that year of assessment, from the trade or business in which the loss was incurred and shall be made as far as possible from the amount of such assessable profits of the next year of assessment and so on.

(iii) The period for carrying forward any loss is limited to four years after which any unrelieved loss shall lapse up to 2006 year of assessment. From 2007 YOA the relief is indefinite.

Illustration

Kolokolo Limited has been in business for many years and reported the following results from its various sources:

	Trading	**Hotel**	**Rent**
	N	N	N
2013	350,750	(96,742)	45,780
2014	392,480	34,900	49,020
2015	458,920	24,450	52,412
2016	574,820	28,490	56,460
2017	579,200	18,490	57,808

You are required to compute the total profit of the company for the relevant years of assessment.

Solution

Kolokolo **Limited**

Computation of Total Profit

2014:	N	N
Trading		350,750
Hotel		-
Rent		45,780

Total Income			396,530
Loss for the year	96,742		
Loss carried forward	96,742		
Assessable Profit			396,530

2015:

Trading			392,480
Hotel			34,900
Rent			49,020
Total income			476,400
Unrelieved loss b/f		96,742	
Loss relieved		34,900	(34,900)
Unrelieved loss c/f		61,842	
Assessable profit			441,500

2016:

Trading			458,920
Hotel			24,450
Rent			52,412
Total Income			535,782
Unrelieved loss b/f	61,842		
Loss relieved	24,450		(24,450)
Unrelieved loss c/f	37,392		
Assessable profit			511,332

2017:

Trading		574,820
Hotel		28,490
Rent		56,460
Total income		659,770
Unrelieved loss b/f	37,392	
Loss relieved	(28,490)	(28,490)
Unrelieved loss c/f	8,902	
Assessable profit		631,280

2018:

Trading		579,200
Hotel		18,490
Rent		57,808
Total Income		655,498
Unrelieved loss b/f	8,902	
Loss relieved	(8,902)	(8,902)
Assessable profit		646,596

Illustration

PAN Limited which is in business as wholesale distributor, also has a laundry dry cleaning business. Its results for the accounting year ended 30th September, 2013 are as follows:

		N
Adjusted profit:	Trade	527,500
	Laundry	56,740

Capital Allowance	79,280
Balancing charge	4,000
Balancing Allowance	9,000
Loss brought forward (laundry)	(96,482)

You are required to compute the total profit of the company for the 2014 year of assessment.

Solution

PAN Limited

Computation of Total Profit for 2014

	N	
Adjusted profit: Trade		527,500
Laundry		56,740
		584,240
Add Balancing Charge		4,000
Assessable profit		588,240
Less loss brought forward	96,482	
Loss relieved	(56,740)	(56,740)
Unrelieved loss c/f	39,742	
Assessable profit		531,500
Less capital Allowance	79,280	
Balancing Allowance	9,000	
Capital Allowance for the year	88,280	
Capital allowance relieved	(88,280)	(88,280)

Chargeable Profit	443,220

Note: Despite the available profit of N588,240 that can absorb, the total loss brought forward of N96,482 it is only restricted to a relieve of N56,740 which is the available profit from the source for which the loss was incurred.

Payment of Minimum Tax by Companies

Where in any year of assessment, the ascertainment of the total assessable profit of a company from all sources results in a loss or where a company's ascertained total profits results in no tax payable or tax payable which is less than the minimum tax, there shall be levied and paid by the company the minimum tax as prescribed by Section 28A(2) of CITA.

For a company which has been in business for at least four calendar years with a turnover of less than N500,000 the minimum tax shall be the highest of either:

0.5 percent of gross profit or

0.5 percent of net assets or

0.25 percent of paid-up capital or

0.25 percent of the turnover.

Where the turnover is in excess of N500,000, for the purpose of computing the minimum tax, the excess of the turnover over the N500,000 will be calculated by applying 0.125% and adding same to the highest.

The minimum tax as prescribed in the above cited section. These do not apply to a company which:

a. Has been in business for four calendar years or less.

b. Has at least 25% imported equity capital.

The capital allowance claimable by a company to which the minimum tax is applicable shall be computed and deducted as far as possible from the assessable profit and as far as cannot be deducted shall be carried forward to future years.

Illustration

Joko Nigeria Limited, a company engaged in the manufacture of biscuits, has the following results for the year ended 31st December, 2016.

	N
Turnover	5,215,079
Less Cost of Sales	(4,247,397)
Gross profit	967,682
Less Expenses	2,116,874
Net loss for the year	(1,149,192)

Extract from the company's balance sheet are as follows:

Paid-up Capital	2,000,000
Net Assets	1,735,042

You are required to compute the minimum tax payable by the company for the 2007 assessment year.

Solution

Joko Nigeria Limited

Computation of Minimum Tax Payable for 2017 Year of Assessment

	N
Minimum Turnover	5,215,079
N500,000 at 0.25%	1,250
Gross profit for 2006 N967,682	
N967682 at 0.5%	4,838
Net Assets N1,735,042	
N1,735,042 at 0.5%	8,675

Paid up capital N2,000,000	
N2,000,000 at 0.25%	5,000
Excess of turnover 500,000	
5,125,079 – 500,000 = 4,715,079	
4,715,079 at 0.125%	5,894
The highest of the above	8,675
Plus tax on turnover in	
Excess of N500,000	5,894
Minimum tax payable	14,569

Illustration

Star Limited has been in business for many years. The following notes relate to the company for the year ended 31st December, 2017.

	N
(i) Unabsorbed Capital Allowance b/fwd	404,900
(ii) Capital allowance for the year	375,400
(iii) Depreciation charged for the year	427,500
(iv) Unrelieved loss brought forward	89,700

The accounts for 2016 were as follows:

Star Limited

Statement of Financial Position as at 31st December, 2016

	N	N
Fixed Assets		2,458,000

Current Assets	6,849,000
Less current liabilities	(4,382,999)
Net Current Assets	2,467,000
Total Net Asset Employed	4,925,000
Financed by:	
Share Capital	1,000,000
Capital Reserve	1,345,000
General Reserve	985,000
Long-term Loans	1,584,000
Total Funds Employed	4,925,000

Star Limited

Profit or Loss Account for the Year Ended

31st December 2016

	N
Turnover	7,504,000
Cost of Sales	(3,108,000)
Gross Profit	4,396,000
Less Expenses	(3,848,000)
Net Profit	548,000

You are required to compute the company's tax liability for the 2017 year of assessment taking into consideration the requirement of CITA relating to minimum tax payable. The applicable rate of company tax is 30%.

Solution

Star Limited

Income Tax Computation for 2017 Year of Assessment

		N	N
Profit per account			
Add Depreciation			548,000
Adjusted profit			427,500
			975,500
Unrelieved loss b/f			(89,700)
Assessable profit			885,800
Less Capital Allowance:			
	Capital Allowance b/f	404,900	
	For the year	375,400	
		780,300	
	Amount relieved	(590,533)	(590,533)
	Capital Allowance c/f	189,767	
	Chargeable profit		295,267
	Tax liability at 30%		88,580
	Minimum Tax payable		33,380

Computation of Minimum Tax liability

(a) Gross Profit for 2016 N4,396,000 N

N 4,396,000 at 0.5% 21,980

(b) Net Assets for 2016, N4,925,000

N4,925,000 at 0.5%	24,625

(c) Paid up capital as at 31/12/16 N1,000,000

N1,000,000 at 0.25%	2,500

(d) Turnover N500,000

N500,000 at 0.25%	1,250	
Turnover in excess of N500,000		
7,504,000 -500,000		
=7,004,000 at 0.125%		8,755
Minimum Tax liability = 24,625 + 8,755=		N33,380

From the above computation the highest is N24,625 i.e. Tax based on net assets. The minimum tax payable by the company is N24,625 + N8,755= N33,380. This is less than the computed tax liability of N88,580. Hence the tax payable by the company for the year will be N88,580.

The Export Processing Allowance

A company that incurs qualifying expenditure in respect of building or plant and equipment in an approved manufacturing activity in an export processing zone shall be granted a 100% capital allowance in any year of assessment. A company granted the export processing zone allowance does not qualify for an investment allowance.

Pre-Operational Levy

A company that has not commenced business, six months after the date of incorporation, for each year that it obtains a tax clearance certificate shall be liable to a pre-operational levy of;

a. N20,000 for the first year and

b. N25,000 for every subsequent years, before a tax clearance certificate is issued.

Tax Clearance Certificate

Whenever the Board is satisfied that tax assessment on a company has been fully paid or that no tax is due from the company, it shall issue a tax clearance certificate which should state in respect of the three preceding years of assessment:

a. The total profit or chargeable profit of the company.

b. Tax payable thereon.

c. The outstanding tax or a statement that no tax is outstanding.

The Board is required to issue the tax clearance certificate on demand within two weeks or give reasons for failure to issue the certificate. Section 80 of CITA provides for any ministry, department, government agency or any commercial bank with whom a company may have dealings to demand for the certificate of tax clearance. The transactions in respect of which a company may be required to present a tax clearance certificate include:

- Application for any government loan.
- Registration of motor vehicle.
- Application for firearms license.
- Application for foreign exchange.
- Application for certificate of occupancy.
- Application for award of government contracts.
- Application for trade license.
- Application for the approval of building plans
- Application for the transfer of real property.
- Application for export license.
- Application for plot of land.
- Application for buying agent's license.
- Application for pools and gaming license.
- Application for registration of contractors.

- Application for distributorship.
- Stamping of guarantor's form for Nigerian passport.
- Application for the registration of Limited Liability Company or registration for business name.
- Application for allocation of market stalls.
- Stamping of the statement of the amount of normal share capital.
- Stamping of statement of the amount of loan capital.

Illustration

Leg Trading Company Limited has the following results for the accounting year ended 31st December, 2016.

	N	N
Gross Trading Profit		5,429
Sundry Income		249
Less Expenses:		
Salaries & Wages	1,479	
Electricity and Power	98	
Depreciation	374	
Rent and Rates	280	
Repairs & Maintenance	480	
Fuel and Oil	260	
Interest & Bank Charges	330	
Bad and doubtful debts	96	
Legal and Professional Fees	296	
Sundry Losses	424	

Company Pensions Contributions	146	
Audit Fees	200	
Donations & Subscriptions	150	
Directors' Emoluments	186	
Miscellaneous Expenses	128	(4896)
Net profit		N782

The following additional information is also made available:

i. Bad and doubtful debts comprise:

5% provision	36
Debts under litigation	49
Write-offs	58
Bad debts recovered	(47)
	96

ii. Sundry losses include:

Goods lost not insured	108
Finance director's misappropriation	297
Cashier's embezzlement	19
	424

iii. Sundry income include:

Dividend received from quoted companies	186
Profit on disposal of fixed assets	63
	249

iv. Legal and professional fees include:

Debt collected commission	39	
Renewal of lease	96	
Mortgage registration fees	53	
Legal retainership	<u>108</u>	
	<u>296</u>	

v. Miscellaneous expenses are:

Penalty for late payment of PAYE deduction	12	
Road Safety Commission fine on delivery		
Van driver's traffic offence	2	
Loss on exchange for import remittances	96	
Office beverages	<u>18</u>	
	<u>128</u>	

vi. Donations and subscriptions are:

Taraba State Building Materials Traders Association	25	
People's club of Nigeria	40	
Church Building Fund	<u>85</u>	
	<u>150</u>	

vii. Salaries and wages include:

Payment in lieu of notice to a former director	125	
Gratuity to retired staff	186	
Salaries and allowances for the year	<u>1,168</u>	

viii. Capital allowance for the year agreed <u>1,479</u>

With the Revenue	204
Balancing charge on disposal of fixed assets	36

You are required to compute:

a. The adjusted profit of the company for the year ended 31st December 2016 and

b. The company's income tax liability for the 2017 year of assessment. The applicable company income tax rate is 30%. Rate of withholding tax is 15%.

Solution

Leg Trading Company Limited

Income Tax Assessment for 2017 Computation of Adjusted Profit

	N	N
Profit per amount		782
Add provision for doubtful debts	36	
Embezzlement and Misappropriation	316	
Mortgage registration fee	52	
Fines and penalty	14	
Donations	125	
Gratuities	186	
Depreciation	374	1,104
		1,886
Less: Profit on disposal of fixed Assets	63	
Dividend from Quoted companies	186	(249)

Adjusted profit for the year	1,637

Hand Trading Company Limited

Income Tax Assessment for 2017

Computation of Income Tax Liability

	N
Adjusted profit for 2017	1,637
Add Balancing charge	36
Assessable profit	1,673
Less Capital Allowance	(204)
Chargeable profit	1,469
Tax payable at 30% thereon	440
Education tax 2% of Assessable profit	33

Notes:

(i) Uninsured losses of cash or goods are allowable deductions while loses as a result of staff misappropriation or embezzlement are not allowed, regardless of the status of the staff involve.

(ii) Mortgage registration fee is not an allowable expense but the lease renewal fee will be allowed.

(iii) All fines and penalties are not allowable; losses on exchange of remittances are allowable deductions while losses on foreign currency conversion for balance sheet purpose are not allowable.

(iv) Subscriptions to trade association are allowable but donations to religious organisation are not allowable unless they are included in the list of bodies approved for donations.

(v) Payment in lieu of notice is allowable, while gratuity payment will not be allowed.

Where Companies are in a Partnership

Where two or more companies enter into a joint venture agreement or partnership then:

a. The joint venture or partnership is not chargeable to tax.

b. The profit chargeable to tax in the hand of each of the partners is the share of profit of the partnerships.

c. Capital allowance on the assets of the partnership shall be shared in the agreed profit or loss sharing ratio.

d. Where any of the companies involved in the partnership has another line of business, the loss generated from the business will not be available to set-off the profit generated from the partnership.

Illustration VI

Dada Limited makes up its accounts to 31st August every year. It entered into a partnership with Tolu Plc, which makes up its accounts to 31st October every year. The partnership makes up its accounts to 31st December every year and the two companies agreed to share profits and losses in the ratio 2:1

You are required to compute the assessable profit for the relevant tax years:

Year ended 31st December 2006	N6,300
Year ended 31st December 2007	N5,700
Year ended 31st December 2008	N3,900

Solution VI

Dada Limited

Computation of Assessable Profits for the Relevant Tax Years

Year Basis Period Assessable profit

2008	1/9/06-31/08/07	4,200 (2/3 x 6300)
2009	1/9/07-31/08/08	3,800 (2/3x 5700)
2010	1/9/08-31/08/09	2,600 (2/3 x 3900)

Tolu Plc

Computation of Assessable profit for the relevant tax year

Year	Basis Period	Assessable profit
2008	1/11/06-31/10/07	2100 (1/3 x 6300)
2009	1/11/07-31/10/08	1900 (1/3 x 5700)
2010	1/11/08-31/10/09	1300(1/3 x 3900)

The computation looks quite simple but care must be taken to understand that the basis period for assessable profit is not for the partnership business is made to the accounting period of the individual partners. Consequently, the partnership income is like an investment income which must be recognized in the period it is received.

Where a Company is Sold or Transferred

Where a company is sold or transferred to another company either for the purpose of better organization or transfer of management and provided that the Board is of the opinion that both companies belong to the same holding company.

There will be no application of either the commencement or cessation rules

All the qualifying capital expenditure transferred are deemed to have been made at their tax written down value. The balancing adjustment may be computed.

In the computation of capital allowance, no initial allowance will be computed while the annual allowance would be based on the unexpired tax life of the qualifying capital expenditure.

Any unutilized capital allowance transferred are deemed to have been transferred prior to the sale.

Any unrelieved losses transferred are also deemed to have been relieved prior to the transfer or sale.

Where a Company is reconstituted

For a recognized company;

a. There will be no application of either the commencement or cessation rules

b. All the qualifying capital expenditure transferred are deemed to have been made at their written down value. The balancing adjustment may be computed.

c. In the computation of capital allowance no initial allowance will be granted while the annual allowance would be based on the unexpired tax life of the qualifying capital expenditure.

d. Any unutilized capital allowance transferred is deemed to have been transferred prior to the sale.

e. Any unrelieved losses transferred are deemed to have been incurred on the first day of the reconstitution. Such a loss is then available for relief against the taxable profit of the year of reconstruction and the three subsequent tax years.

Where a Company Merges with another Company

Where a company merges or amalgamates with another company to form a new company;

a. The commencement rule is applicable to the newly formed company as it is deemed to have commenced a new business.

b. The cessation rule is applied on the companies that are merging as they are deemed to have folded up.

c. The qualifying capital expenditure transferred are deemed to have been made at their agreed values. This will result in the computation of balancing adjustment.

d. No initial allowance will be claimed on the transferred assets. Annual allowance to be claimed must be based on the unexpired tax life of the qualifying capital expenditure.

Illustration

Oluwa Limited merged with Dada Limited in December 2017, as at the time of the merger, the following information was provided in respect of the two companies.

Oluwa Limited

Year ended 31st December	Assessable profit
2015	N180,000
2016	N200,000
2017	N250,000

Dada Limited

Year ended 31st December	Assessable profit
2015	N182,000
2016	N258,000
2017	N400,000

As a consequence of the merger a new company Tolu Limited was formed with effect from 1st January, 2008. The following results were presented by the newly formed company.

Year ended 31st December 2018	N450,000
Year ended 31st December 2019	N700,000
Year ended 31st December 2020	N672,000

You are to determine the basis of assessing the merged companies and the newly formed company.

Solution

Oluwa Limited

Basis Period for Determination of Assessable Profit for the Relevant Years

Original **Revised**

Tax year	Basis Period	Assessable Profit	Basis Period	Assessable Profit

		N		N
2016	1/1/15-31/12/15	180,000	1/1/16-31/12/16	200,000
2017	1/1/16-31/12/16	200,000	1/1/17-31/12/17	250,000

Conclusion: Oluwa Limited will be assessed on the basis of the revised assessable profit because it will result in a higher tax liability.

Dada Limited

Basis Period for Determination of Assessable Profit for the Relevant Years

Original			**Revised**	
Tax year	Basis Period	Assessable Profit	Basis Period	Assessable Profit
		N		N
2006	1/1/05-31/12/05	182,000	1/1/06-31/12/06	258,000
2007	1/1/06-31/12/06	400,000	1/1/07-31/12/07	400,000

Conclusion: Dada Limited will be assessed on the basis of the revised assessment because it will result in a higher tax liability.

Tolu Limited

Basis Period for Determination of Assessable Profit for the Relevant Years

Normal			**Election**	
Tax year	Basis Period	Assessable Profit	Basis Period	Assessable Profit
		N		N

2008	1/1/08-31/12/08	450,000		
2009	1/1/08-31/12/08	450,000	1/1/09-31/12/09	700,000
2010	1/1/09-31/12/09	700,000	1/1/10-31/12/10	672,000
		1,150,000		1,372,000

Conclusion: Tolu will be assessed in the second and third year on the normal basis, because it will exercise its rights of election. This will minimize its tax liability.

Comments:

(i) Both merged companies are deemed to have ceased business and the basis of assessment is premised on the cessation rule.

(ii) The newly formed company is deemed to have commenced a new business. The assessment is based on the commencement rule.

Taxation on Dividend

Where a company either

a. Does not have a taxable profit or

b. The dividend declared and distributed to the shareholders exceeds tax payable, the dividend declared shall be treated as the taxable profit of the company and subjected to tax in the hands of the company accordingly.

This is the position where a company has generated enough capital allowance to match the assessable profit. It could also be that the company has recorded a loss, and consequently, the company declares dividend to the shareholders. Any such dividend paid automatically becomes the taxable profit chargeable to tax at the ruling corporate income tax rate.

Waiver or Refund of Liability

Where an allowable deduction under the provision of CITA in respect of any liability is subsequently waived or released and an expense is refunded, the amount of the liability or expense is treated as a taxable profit of the company from the date of the waiver, release or refund.

Treatment of Losses

Where loss is incurred by a company, except for the provisions of minimum tax, no tax will be due. Such a loss may be carried forward for relief against future profits of the company. It must be noted that losses incurred may only be carried forward for a maximum period of four tax years up to 2007 year of assessment. The only exception to this rule then is where the business is an agricultural trade or business. For an agricultural trade or business, losses may be carried forward indefinitely. In the treatment of losses for a company, it must be emphasized that losses are relieved on the carry forward basis.

Under the Carry Forward Loss Relief System

a. Relief of losses is automatically granted i.e. no formal application is required

b. Loss may only be relieved from the profit generated from the same source of income i.e. the loss from source 'A' may not be relieved against profit from source 'B'.

c. This form of relief is applicable to both individuals and companies

d. Losses incurred by a property letting business may only be relieved under this system.

Losses used in Aggregation

In the application of the commencement rule, a date may be used more than once. The implication is that where the first account is prepared for a period that is not less than twelve months and the first accounts shows a loss; losses would have to be used in aggregation. The implication is that aggregated losses will exceed that actual loss incurred by the business. Where this occurs, the provision of the law is that the amount of loss to be relieved should not exceed that actual loss incurred.

The difference between the actual loss incurred and the aggregated losses is the nominal loss which is not available for relief.

Terminal Loss

If after the cessation of business, there are still some unrelieved losses, they can no longer be carried forward. They are thus deemed to be terminal loss which becomes permanently lost.

Illustration

Taiye Venture has been having problems with the tax authorities recently for which your firm has been retained to help them sort out the problem. A close look at the tax computation for the year showed the following details:

Computation of tax Liability for 2016 Year of Assessment

	N	N
Net profit reported		246,500
Add excess rent	400,000	
Depreciation	248,500	
Donation	49,500	
Loss on sale of fixed assets	15,300	713,500
Adjusted profit		960,000
Capital allowance		(199,500)
Taxable profit		760,500
Tax at 30%		N228,150

On further enquiry, you got the following additional information

(a) Rent paid for the accommodation of staff	680,000
Deduct rent of N56,000 for five staff	(280,000)
Amount disallowed	400,000

The rent paid per building was N136,000 per annum for all the members of staff. Top senior staff are on the following basic salaries. Two of them were on N120,000 p.a. and the other three were on N130,000 p.a.

(b) A schedule of donation disallowed included

1. Troops Comfort Fund.
2. Nigerian Shooting Association.
3. Ibadan Progressive Union.

(c) Accumulated losses brought into 2016 tax year but which was treated as lapsed was N678,365 broken down as follows

Tax year	Loss
	N
2009	100,000
2010	150,300
2011	193,000
2012	235,065
	678,365

(d) The tax written down value of assets as at the end of 2015 tax year were as follows:

Motor vehicles (2) Residual year = 3)	300,000
Furniture & Fittings (15) (Residual year = 2)	198,000
Plant (2) Residual year = 2)	200,000

A claim of N199,500 was made on this basis during 2016 tax year.

(e) Franked Investment income of N60,000 is included in net profit

You are required to do a recomputation of the tax liability of Taiye Venture Limited.

Solution VIII

Taiye Venture

Recomputation of Tax Liability for 2016 Tax Year

	N	N
Net profit		246,500
Add rent (680-630)	50,000	
Donation	14,700	
Deprecation	248,500	
Loss on sale of fixed assets	15,300	
		328,500
		575,000
Less franked investment income		(60,000)
Adjusted profit		515,000
Less Losses brought forward	678,365	
Relieved	(235,065)	(235,065)
Unrelieved loss lapsed	443,300	
Assessable profit		279,935
Less Capital Allowance	299,000	
Relieved 2/3 x 279,935)	(186,623)	(186,623)
Capital Allowance c/f	112,377	
Taxable profit		93,312
Tax at 30%		27,994
Education tax		5599
Total tax due		33,593

Note: Capital Allowance = 300,000 = 100,000

		3		
Furniture	=	198,000	=	99,000
		2		
Plant	=	200,000	=	100,000
		2		299,000

Illustration

Abiola Merchant Bank Ltd with its registered office in Lagos commenced business operations on 1st April, 2008 and decides to prepare its accounts to 30th November of every year. The audited accounts of the bank for the first twenty one months showed the following results.

	1/4/08-30/11/08	1/12/08-30/11/09
	N	N
Interest income:		
Money at call and short notice	14,000	814,000
Treasury bill	155,000	245,000
Gains on disposal of Govt. securities	-	14,000
Bankers' acceptance	667,000	1,194,000
Trust Receipt	45,000	210,000
Income on Agric Loan (see notes 3)	142,000	152,000
Income on loan for export (see note 2)	141,000	242,000
Others	154,000	686,000
Other income:		
Foreign exchange	450,000	860,000
Profit on sales of fixed Assets	-	21,000

Commission received	15,000	35,000
Rental income on lease	151,000	255,000
Discounts	259,000	459,000
	2,193,000	5,907,000
Less interest expenses	410,000	540,000
Salaries and wages	530,000	550,000
Rent	319,000	410,000
Depreciation	199,000	850,000
Repairs and maintenance	210,000	310,000
Provision for doubtful debts (specific)	152,000	165,000
Other expenses (all allowable)	710,000	950,000
	2,530,00	3,775,000
Net profits/Loss	(337,000)	2,132,000

The following additional information is relevant :

1. Qualifying capital expenditure are listed below

Nature of expenditure	Amount	Date of Acquisition
	N	
Motor vehicles-Cars	115,000	July, 2008
Motor vehicles-Buses	250,000	November, 2008
Furniture and Fittings	114,000	August, 2008
Office Equipment	94,000	September, 2008
Buildings	200,000	February, 2009

Two motor cars purchased for N45,000 in July were sold for N55,000 in November, 2009.

2. Schedules of interest on export Loan

Period 1st April, 2008 to 30th November, 2008

Period of repayment with Moratorium	Grace Period	Amount of Interest
		N
5 to 10 years	1 ½ years	50,000
2 to 5 years	1 year	45,000
1 to 2 years	½ year	46,000
		141,000

1st December, 2008 to 30th November, 2009

Period of repayment With Moratorium	Grace Period	Amount Interest
		N
5 to 10 years	1 ½ years	80,000
2 to 5 years	1 year	120,000
1 to 2 years	½ year	42,000
		242,000

You are required to compute the total tax liability of the bank for the first three years of Assessments.

Note: Assume capital rate of:

	Initial Allowance	Annual Allowance
Motor vehicles	50%	25%

Furniture and fittings	25%	20%
Office building	15%	10%
Office equipment	25%	20%

Ignore investment allowance and tax payer's right of election.

Solution

Abiola Merchant Bank Limited

Computation of Adjusted profit for the period ended

	14/08-30/11/08	**1/12/08-30/11/09**
	N	N
Net profit/loss	(337,000)	2,132,000
Add back depreciation	199,000	850,000
	138,000	2,982,000
Less gains on disposal		
of government securities	-	(14,000)
Profit on sale of fixed assets	-	(21,000)
Exempted Income on export loans	(53,000)	(104,000)
Exempted income on agric loan	(42,000)	(152,000)
Adjusted profit	(233,000)	2,691,000

Abiola Merchant Bank Limited

Income Computation for the relevant tax year

	N	N

2008 Tax years Basis period (1/4/08-31/12/08)

Assessable loss c/f		8750
Capital Allowance		292,119
Total profit		Nil

2009 Tax year Basis Period (1/4/08-31/3/09)

Assessable profit		664,000
Add balancing charge		16,313
		680,313
Capital allowance b/f	292,119	
For the year	123,483	
Relieved	415,602	
	(415,602)	415,602
		Nil
Total profit		264,711
Tax liability at 30%		79,413
Education tax 2% x 664,000		13,280
Total tax liability		92,693

2010 Tax year on preceding year basis (1/12/08-30/11/09)

Assessable profit	2,691,000
Less capital Allowance	93,483
Total profit	2,597,517
Tax liability at 30%	779,255

Education tax (2% x 2,691,000)	53,820
Total tax liability	833,075

Workings

Abiola Merchant Bank Limited

Computation of Capital Allowance

		Motor Vehicles	**Office Equipment**	**Furniture & Fittings**	**Total Capital Allow.**
	Rates	50/25%	25/20%	15/10%	
		N	N	N	**Total**
2008	Tax year				
	cost	365,000	208,000		
	Initial allowance	(182,500)	(52,000)		234,500
	Annual Allowance				
	9 Months	(34,219)	(23,400)		57,619
	TWDV	148,281	132,600		292,119
2009	TWDV b/f	148,281	132,600		
	Disposal	(18,281)	-		
	additions	-	-	200,000	
	Initial Allow.	-	-	(30,000)	30,000
	Annual Allow.	(43,333)	(33,150)	(17,000)	93,483
	TWDV	86,667	99,450	153,000	123,483
210	TWDV b/f	86,667	99,450	153,000	

Annual Allow	(43,333)	(33,150)	(17,000)	______
	43,334	63,300	136,000	93,483

Notes:

1. **Computation of annual allowance**

2008 tax year: Motor Vehicles

A.A = 365,000 - 182,500 x 9/12 x 25/100 = 34,219

Furniture, fittings & equipment

AA= 208,000 - 52,000 x 9/12 x 20/100 = 23,400

2009 tax year

Motor Vehicles

$$A.A = \frac{148{,}281 - 18{,}281}{4 - 1} = 43{,}333$$

Furniture, fittings & equipment

$$A.A = \frac{132{,}600}{5 - 1} = 33{,}150$$

Building

$$A.A = \frac{200{,}000 - 30{,}000}{10} = 17{,}000$$

2. **Computation of tax written down value**

Motor vehicles		N
2008 Tax year cost		45,000
Annual Allowance (9 months)		(22,500)
2009 Tax written down value		4,219
Sales proceeds		18,281
Balancing charge		55,000
		36,719
Restricted to total capital allowance granted		26,719
Capital gains	10,000	

3. **Basis period for assessable profit**

Year	Basis period	Assessable Profit
		N
2008	1/4/08-31/12/08	(8,750)
2009	1/4/08-31/3/09	664,000
2010	1/12/08-30/11/09	2,691,000

2008 tax year	1/4/08-30/11/08	(233,000)
	1/12/08-31/12/08	
	1/12 x 1,290,000	224,250
		(8,750)

2009 tax year 1/4/08-30/11/08

1/1/08-31/03/09	(233,000)
4/12 x 1,269,000	897,000
	664,000

4.09 Education Tax Fund

Composition

The Education Tax Fund Trustees is established under Section 4(1) of ETA 2004 and its members include:

a. A chairman.

b. Eight other members.

c. A representative each of the Federal Ministries of Finance and Education who shall not be below the rank of a Permanent Secretary; and

d. The Executive Secretary who shall be the Secretary to the Board of Trustees.

The members are drawn from the six geo-political zones of the Federation and are appointed by the President on the recommendation of the Minister of Education. The members should be persons with considerable experience from both the public and private sectors to represent the business, financial and education sectors. Each member (excluding ex-officio member) is to hold office for four years in the first instance and may be reappointed for another four years and no more. The members are entitled to remuneration/allowances as the President may, from time to time determine.

Meeting

The Board is to meet not less than four times in a year at such times, places and on such days as the chairman may appoint. The chairman will also summon a meeting if he is required to do so by notice given to him by not less than three other members. The meeting shall be held within fourteen days from the date on which the notice is given. Any person co-opted into the Board shall not be entitled to vote at any meeting of the Board and shall not count towards a quorum. A quorum is formed with any five members of the Board.

The Executive Secretary

The executive Secretary, who is the chief executive and accounting officer of the Fund, is appointed by the President on the recommendation of the Minister of Education. He should be a person with good knowledge in administrative matters and have appropriate qualifications and experiences to perform the functions of that office. He is to hold office for five years in the first instance and may be reappointed for another five years and no more.

The Executive Secretary is responsible for:

a. The day-to-day administration of the Fund;

b. The keeping of the books and proper records of the proceeding of the Board of Trustees;

c. The administration of the secretariat of the Board of Trustees and the general direction and control of all other employees of the Fund.

Cessation of Membership

Section 5 of ETA 2004 provides that:

1. A member of the Board of Trustees shall cease to hold office if

    a. He becomes of unsound mind; or

    b. He becomes bankrupt or make a compromise with its creditors; or

    c. He is convicted of a felony or nay offence involving dishonesty; or

    d. He is guilty of serious misconduct in relation to his duty.

2. A member of the Board of Trustees may be removed for officer by the President if he is satisfied that it is not in the interest of the Fund or the public that the member should continue in office.

3. A member of the Board of Trustees, other than an ex-officio member, may resign his appointment by a notice in writing under his hand, addressed to the President.

4. Where a vacancy occurs in the membership of the Board of Trustees, it shall be filled by the appointment of a successor to hold office for the remainder of the term of the office of his predecessor, so however that the successor shall represent the same interest and shall be appointed by the President.

Functions of the Board of Trustees

Section 6 of ETA 2004 provides that the Board of Trustees shall have responsibility to:

a. Monitor and ensure collection of tax by the Federal Inland Revenue Service and ensure transfer to the Fund;

b. Manage and disburse the tax;

c. Liaise with the appropriate ministries or bodies responsible for collection or safe keeping of the tax;

d. Receive requests and approve admittable projects after due consideration;

e. Ensure disbursement to various levels and categories of education;

f. Monitor and evaluate execution of the projects;

g. Invest funds in appropriate and safe securities;

h. Update Federal Government on its activities and progress through annual and audited reports;

i. Do such other things as are necessary or incidental to the objects of the Fund under this Act or as may be assigned by the Federal Government.

Disbursement of Education Tax Fund

The Board of Trustees is charged with the responsibility of administering the education tax and disbursing the amount in the Education Tax Fund to Federal, State and Local Government educational institutions including primary and secondary schools, for the restoration, rehabilitation and consolidation of education in Nigeria, but specifically for the following:

a. Work centers and prototype development;

b. Staff development and conference attendance;

c. Library system at different levels of education;

d. Research equipment procurement and maintenance;

e. Higher education book development and maintenance;

f. Redressing any imbalance in enrolment mix as between the higher educational institutions; and

g. Execution of the 9 year compulsory education programme.

The tax is to the disbursed to the various levels of education as follows:

Higher education	-	50%
Secondary education	-	20%
Primary education	-	30%

The amount allocated to the higher education is to be distributed to the universities, polytechnics and colleges of education in the ratio of 2:1:1.

The concept of ETF is now changed to TETFUND in the year 2011.

Offences and Penalties under Education Tax Act 2004

Failure to pay the education tax on the due date (i.e. within 60 days after the service of notice of assessment on the company) attracts a penalty of 5% of service of the tax unpaid. A **demand note** shall be served on the company for the unpaid tax plus penalty and if payment is not made within two months of the demand, the company shall be guilty of an offence. The FIRS shall, with the approval of the Board of Trustees, remit in whole or in part the penalty.

Where a company commits an offence under ETA, every director, manager, secretary or other similar officer of the company is severally guilty of that offence and liable for punishment, unless he proves that the act or omission constituting the offence took place without his knowledge, consent or connivance.

A person guilty of an offence under ETA shall be liable:

a. For the first offence, to a fine of N10,000 or imprisonment for a term of three years.

b. For a second and subsequent offence, to a fine of N20,000 or imprisonment for a term of five years or to both such fine and imprisonment.

Payment of penalty does not in any way discharge a company’s liability to pay to tax due.

4.10 Information Technology Development Levy

The National Information Technology Development Agency Act, 2007 imposes a levy of 1% on the **profit before tax** of companies and enterprises listed below with an annual turnover of N100 million and above. The businesses are as follows:

a. GSM service providers and all telecommunication companies;

b. Cyber companies and internet providers;

c. Pension managers and pension related companies;

d. Banks and other financial Institutions;

e. Insurance companies.

The levy when paid by the companies shall be **tax deductible**, that is, the levy is an allowable deduction in computing a company's profits for tax purposes. All monies accruing to the National Information Technology Development Fund and accounts of the National Information Technology Development Agency form the sources specified in the Act shall be exempted form income tax and all contributions to the Fund and the accounts of the Agency shall be tax deductible.

It should be noted that the NITDA does not define the **'profit before tax'** on which the levy is to be imposed. Therefore, the profit to be used should be as defined in the tax legislations. That is **assessable profit** ascertained in accordance with the Companies Income Tax Act and not the accounting profit.

4.11 Review Questions

Jovita Ltd is a Nigerian telecommunication company. The profit or loss account of the company for the year ended 31st December, 2009 showed the following:

	N
Profit of the year after charging	950,000
Depreciation	280,000
General provision for doubtful debts	130,000

Donations to political parties	500,000

Additional information:

a. Capital allowances agreed for the year ended 31st Dec. 2009:

Annual allowance	205,000
Balancing charge	55,000
b. Unrelieved losses brought forward	124,000

Required: Compute the information technology levy payable by the company. Ignore education tax.

Solution

Jovita Limited

Computation of Information Technology Levy

	N	N
Profit for the year per profit and loss account		950,000
Add disallowable expenses:		
Depreciation		280,000
General provision for doubtful debts		130,000
Donations to political parties	500,000	910,000
		1,860,000
Less:		
Information technology development levy		18,416
Adjusted/assessable profit		N1,841,584

Tutorial Note

In accordance with Section 12(2)(a) of NITDA, Information Technology Development Levy is tax deductible, which means that the levy must be deducted before arriving at the adjusted/assessable profit of a company. The implication is that the levy should be computed as 1% of assessable profit remaining after deduction of the levy and not as 1% of assessable profit before such levy is deducted.

In the above example, the adjusted/assessable profit before the deduction of the levy amounted to N1,860,000. If 1% of N1,860,000 is calculated as ITD levy, the levy will be N18,600 and the assessable profit remaining after the levy will be N1,841,400. Unfortunately, 1% of N1,841,000 gives N18,410 hence the answer of N18,600 is incorrect! The correct formula to be applied in the calculation of ITD levy is:

$$\frac{\text{Rate of ITD levy}}{100 + \text{Rate of ITD levy}} \times \text{Adjusted/assessable profit before ITD levy}$$

Applying the formula, the correct answer is:

$$\frac{1}{100+1} \times N1{,}860{,}000 = N18{,}415.84 \text{ ITD levy}$$

The assessable profit remaining after ITD levy is N1,841,584.16 and as 1% of N1,841,584.16 is N18,415.84 the answer has been confirmed as being correct.

Assessment and Collection of ITD Levy

The National Information Technology Development Agency Act, 2007 empowers the FIRS to assess and collect the information technology development levy. The assessment of a company for the levy is done at the same time the company is assessed for companies income tax. The ITD levy is due and payable within 60 days after the FIRS has served notice of the assessment on a company.

Offences and Penalties under NITDA 2007

Failure to pay the ITD levy on the due date attracts a penalty of 2% of the levy unpaid. A demand note shall be served on the company for the unpaid levy plus penalty and if payment is not made within two months of the demand, the company shall be guilty of an offence.

Where an offence under NITDA is committed by a body corporate or firm or other association of individuals, every chief executive officer of the body corporate or any officer acting in that capacity or on his behalf and every person purporting to act in that capacity commit an offence, unless he proves that the act or omission constituting the offence took place without his knowledge, consent or connivance.

Anybody corporate or person who commits an offence under NITDA where on specific penalty is provided is liable on conviction:

a. For a first offence, to a fine of N200,000 or imprisonment for a term of one year or to both such fine and imprisonment; and

b. For a second and subsequent offences, to a fine of N500,000 or imprisonment for a term of three years or to both such fine and imprisonment.

The institution of proceedings or imposition of a penalty does not discharge a company's liability to pay the levy due to the FIRS.

MODULE 5

5.00 PIONEER LEGISLATIONS (INDUSTRIAL DEVELOPMENT INCOME TAX RELIEF) ACT, CAP 179 LFN 1990)

5.01 Learning Outcome

On successful completion of this Module, Students should be able to:

i. Evaluate the concept of Pioneer Legislation and its implication for tax purposes;

ii. Proficiently compute the Company Income Tax of a Pioneer Company;

iii. Analyze the legal framework and administration of the Pioneer Legislations in Nigeria.

5.02 Conditions for Pioneer Status

Pioneer company is like any other company incorporated in Nigeria, except that it is a privilege one as the status (pioneer) makes it possible for the affected companies to enjoy certain incentives which are not available to all other companies. The status is conferred under the industrial Development (Tax Relief) Act 1971 No. 22. Pioneer company is therefore any company that is certified by pioneer certificate issued under the authority of the Federal Executive Council. The main purpose of the pioneer status is to encourage development or establishment and process of industrialization in Nigeria, hence incentives are granted to the pioneer industries and products.

The following are qualified to apply for Pioneer Status

a. Any company incorporated in Nigeria

b. A group of persons on behalf of a company, which is to be so incorporated (promoters).

5.03 Conditions for Application for Pioneer Status

Requirements: No application for the issue of certificate shall be made unless the qualifying capital expenditure to be incurred on or before production day:

a. In the case of an indigenous control company is not less than N50,000.00.

b. In-the case of any other company not less than N150,000

The following must also be stated

a. Whether the company or the proposed company when established is going to be an indigenous controlled company.

b. The particulars of the assets on which qualifying capital expenditure will be incurred by the company including their source and estimated cost:

i. On or before production day

ii. During a period of 3 years following production day

c. The place in which the assets are to be taunted.

d. Estimate and state the probable date of production date of the company or proposed company.

e. Specify any product and by-product (not being a pioneer product) proposed to be produced by the company or proposed company and then give a reasonable estimate of the quantities and value of such product and by product during a period of one year from production day.

f. The particulars of loans and share capital or the proposed loan and share. capital including the amount and date of each issue or proposed issue and the sources from which the capital is to be or has been raised.

g. In the case of a company already incorporated, give the name, address and nationality of each director of the company and the number of shares held by him.

h. In the case of a proposed company give the name, address and nationality of each promoter.

i. A declaration signed by the applicant that all the particulars contained in the application are true and an undertaken undertaking to produce proof when required.

j. Include a non-refundable fee of a hundred naira, which is to be credited to the consolidated revenue fund of the Federation.

5.04 Production Day/Material Day

Not later than one month after the material date a pioneer company shall apply in writing to the director to certify the date of its production day. Unusually the company must propose a day to be certified and give reasons for proposing that date.

Production Date therefore is the day on which the business commences for commercial purpose.

Not later than one month after the production date the company must apply to the directors to certify its qualifying capital expenditure incurred prior to production day. In determining the qualifying expenditure however, disposals not made at arm length must be disallowed.

After obtaining all the above certificate and for a period not exceeding 30 days the company shall notify the minister in what respect the proposals and the estimate made in its application for pioneer certificate or any conditions contained therein have not been fulfilled.

5.05 Certification of Pioneer Companies

a. Established Company

A pioneer certificate may specify any by-product, which may be produced by the pioneer company in addition to the pioneer product. It might even limit the proportion of the by-product in relation to the pioneer product either in quantity, in value or both.

b. The Proposed Company

The pioneer certificate must specify the period within which the company must be incorporated, not later than 4 months after the date of notification of the approval to the applicant or any other conditions as deemed necessary when issue. Such certificate may become effective from the date of incorporation or the date such application W3S submitted

Amendment to Pioneer Certificate

a. The pioneer product or products specified in the certificate.

b. State reasons for the application, when application is approved it shall aimed the pioneer certificate of the company.

5.06 Tax Relief Period

The tax relief period of a pioneer company shall commence on the date of production day and shall continue for three years.

The tax relief period may be extended at the end of three years for:

(a) A period of 1 year and thereafter another period of one year commencing from the end of first period of extension.

(b) For one period of two years.

5.07 Conditions for Extension

The Executive Council must be satisfied as to:

(a) The rate of expansion, standard of efficiency and the level of the development of the company.

(b) The implementation of any scheme. For the utilization of local raw material in the processes of the company and

(b) For the training and development of Nigerian personnel in the relevant industry.

(c) The relative importance of the industry in the economy of the country and any other such relevant matter as may be required.

(d) The application should be made not later than 1 month after the expiration of the initial tax relief period of3 years.

Accounting Date

(a) The pioneer trade or business shall be deemed to have permanently ceased at the end of the tax relief period and a new trade commencing on the day next following the end of its tax relief period.

(b) The accounting period shall be:

(i) A period not exceeding one year commencing on its production day.

(ii) A successive periods of 1 year thereafter

(iii) A period not exceeding one year ending at the date when its tax relief period ends.

Section 17-Account

No tax shall be payable during the pioneer period on the profit in the Section 17 Account and consequently no capital allowance could be claimed.

Dividends can be declared out of section 17account but not more than the balance standing in that account. No loan can be granted to any director without the permission of the Minister.

Other incomes derivable but under the pioneer status shall be chargeable to tax under the company income tax accordingly.

Tax Reliefs

(a) Profit of the pioneer company during the relief period shall not attract tax.

(b) Dividend paid out of S 17 account shall not be subject to tax in the hand of first recipient.

(c) No capital allowance shall be claimable on all the qualifying capital expenditure incurred on or before production date and certified accordingly i.e. all qualifying capital expenditure (QCE) shall be deemed to have been incurred on the first date of new trade.

(d) Losses brought forward from the pioneer relief period, shall be available on the first year of the new trade for the computation of the total-profit any part unrelieved in the first year shall lapse accordingly.

5.08 Merits of Pioneer Company

(i) A pioneer company certificate entitles the company to tax exemption for a minimum of 3 years and maximum of 5 years.

(ii) Losses incurred by the pioneer company during the pioneer period and certified by the Board may be relieved alter the pioneer period.

(iii) Dividends declared out of pioneer profits are not taxable.

(iv) The net qualifying expenditure for capital items during the pioneer period are accumulated and are qualified for both initial and annual allowances in the new business.

Demerits of Pioneer Company

(i) A pioneer company is prevented from carrying on any business apart from its pioneer enterprises.

(ii) There is a limitation imposed on a pioneer company in the computation of its allowable trading loss for the purpose of income tax relief.

(iii) There is also a limitation on a distribution of company dividends. No dividend may be distributed in excess of a certain balance on its P or L account.

(iv) A pioneer company cannot be granted loans without the written permission of the Federal Minister for Industries

5.09 Revocation of Pioneer Certificate

It can be revoked under the following conditions:

a. Where it is discovered that the production day is more than one year later than the estimate given in the application for pioneer certificate.

b. Where it is discovered that the qualifying capital expenditure incurred on or before production date is less than:

(i) In the case of an indigenous controlled company N50,000

(ii) In the case of other company N150,000.

c. Upon application of the pioneer company

d. Where the minister is of the opinion that the pioneer company has contravened any provision of this Act.

Effective Date of Revocation

a. Where the company has been in operation as a pioneer company for a period less than one year from the pioneer the effective dark for the cancellation is the Pioneer date.

b. Where the company has been in operation for more than 1 year from the pioneer date; the date of the last anniversary of the pioneer day is the effective date for the revocation.

5.10 List of Pioneer Industries/Products

1. Cultivation and processing of food crops, vegetables and fruits

2. Manufacture of cocoa products.

3. Processing of oil seeds.

4. Integrated dairy production

5. Cattle and other livestock ranching

6. Bone crushing

7. (a) Deep sea trawling and processing

(b) Coastal fishing and crimping

(c) Inland lake fishing and processing

8. Manufacture of salt

9. Mining oflead and zinc ores by underground mining methods

10. Manufactureof iron and steel from iron ore

11. Smelting and refining of non-ferrous base metals and the manufacture of their alloys.

12. Mining and processing of baryttes and associated minerals.

13. Manufacture of oil well drilling materials containing a pre dominant proportion of Nigerian raw materials.

14. Manufacture of cement

15. Manufacture of glass and glassware

16. Manufacture of lime from local limestone

17. Quarrying and processing of marbles

18. Manufacture of ceramic products

19. Manufacture of basic and intermediate industrial chemicalsfrom predominantly Nigeria raw materials.

20. Manufacture of pharmaceutical

21. Manufacture of surgical dressing

22. Manufacture of search from plantation crop

23. Manufacture of yeast, alcohol and related products

24. Manufacture of animal foodstuff

25. Manufacture of paper pulp, paper and paperboard

26. Manufacture of leather

27. Manufacture of articles of paper pulp paper and paperboard

28. Manufacture of textile fabrics and man-made fibbers

29. Manufacture of products made wholly or mainly metal

30. Manufacture of machinery involving the local manufacture of substantial proportion of components thereof.

31. Manufacture of goods made wholly or partly of rubber

32. Manufacture of spare parts including automotive spare parts and components

33. Manufacture of telecommunication equipment, cables, etc.

34. Manufacture of medical and dental equipment

35. Manufacture of educational and science equipment

36. Manufacture of office and school stationery

37. Manufacture of building and home furnishing materials

5.11 Review Questions

1. Dona Ltd. Is a company engaged in the manufacturing of bicycle. It applied for and obtained pioneer status. The following information concern its first few years of operation.

	N'000
1st March 1997 to 30th Sept 1997	(800)
Year to 30th Sept 1998	4,000
Year to 30th Sept 1999	8,500
Year to 30th Sept. 2000	8,200

Required:

(i) Compute the pioneer period profit or loss.

(ii) How should the pioneer period profit or loss be treated?

(iii) Compute the post pioneer period assessable profit or loss.

Suggested solution:

Dona Ltd.

Computation of Pioneer Period Profit or loss

Year	**Profit or (Loss)**
	N'000
1997	(800)
1997/98	4,000
1998/99	8,500
	11,700

(ii) the aggregate balance being a profit in the reserve account will be held in that account for the next 6 years before it can be utilized for any purpose.

(iii) Post pioneer period assessable profit

Yoa	**Basis Period**	**A. I.**
		N'000
1999	/10/99 31/12/99	
	3/12 x 8,200	2,050
2000	1/10/99 – 30/09/00	8,200
2001	PYE 30/09/00	8,200

Notes:

1. In respect of the above, where the aggregate balance is a los, it shall be relieved against the first post-pioneer profit whereupon the unrelieved balance shall lapse.

2. Observed the application of the commencement o business rule provision of CITA 24 (3) immediately after the pioneer period ended in recognition of the commencement of a new business.

2. Osongo Ltd. Is a company involved in the fabrication of carburetor for engineers and cars. The company was granted pioneer status on 31st may 1998 and commenced production since then. The following return s were made available.

	N'000
Period 31st Dec. 1998	(2,500)
Year ended 31st Dec. 1999	(1.060)
Year ended 31st Dec. 2000	1,880
Year ended 31st Dec. 2002	1,960
Year ended 31st Dec. 2002	10,000

Qualifying expenditure were:

i. 4 trailers (heavy duty vehicle) acquired 16th July 1996 N5,000

ii. Industrial building acquired on same date N4,000

iii. 10 Plants & Machinery acquired on 1/1/998 for N10,000

iv. 1 Plant acquired on 31st Dec. 2002 N1,200

Required: Compute the company income tax for the relevant years of assessment.

Suggested solution

Osongo Ltd.

Computation of Company Income Tax for the Relevant Years of Assessment

N'000 **N'000**

2001 YOA		
Assessable Income Wk2		1,960
Loss b/fwd wk1	(1,680)	
Loss relief	1,680	(1,680)
Assessable Profit		280
C. A for year wk3	11,815	
C. A granted	(280)	(280)
Lapsed investment Allow (1500 – 280)		
	(1,220)	
C. A. c/fwd	10,315	_______
Total Profit		Nil
2002 YOA:		
Assessable Income Wk2		1,960
C. A b/fwd		
A. A for yr. wk3	10315	
	2215	12,530
C. A granted	(1960)	(1960)
C. A c/fwd	10,570	
Changeable profit		Nil

2003 YOA:

Assessable Income Wk2		10,000
C. A b/fwd	10,570	
C. A. for year wk 3	3145	
	13,715	
C. A granted	(10,000)	(10,000)
C. A c/fwd	3,715	__________
Chargeable Profit		Nil

WORKINGS:

Wk1: Computation of Pioneer period profit:

Year	Profit/(Loss)
	N'000
1998	(2500)
1999	(1060)
2000	1,880
	(1680)

Wk2: Computation of Assessable Profit

YOA	Basis Period A. I	
2001	1/1/01 31/12/01	2,000
2002	1/1/01 31/12/01	2,000

2003	PYE 2002		10,000

Wk3: Computation of Capital Allowance:

QCE:	**Vehicles I. B**		**P & M**	**C.A**
Rates: I. A%	50	15	50	
A. A%	25	10	25	
	N'000	**N'000**	**N'000**	**N'000**
2001 YOA:				
	Cost	5,000	4,000	10,000
I. A.	(2,500)	(600)	(5000)	8,100
A. A.	(625)	(340)	(1250)	2,215
Investment Allow:	-	-	-	1,500
2002 YOA: TWDV	1875	3060	3,750	11,815
A.A	(625)	(340)	(1,250)	2,215
2003 YOA: TWDV	1,250	2,720	2,500	
Cost	-	-	1,200	
I.A	-	-	(600)	600
A.A	(625)	(340)	(1400)	2365
Investment Allow:	-	-	-	180
2004 YOA: TWDV	625	2380	1,700	3,145

Vehicles. → I A = 5000 x 50% = 2,500

A.A = $\frac{500 - 2500}{4}$ = 625

I.B → I.A = 400 x 10% = 600

A.A = $\frac{10,000 - 5000}{4}$ = $\underline{\underline{1250}}$

Investment Allowance = 10,000 x 15% = 1,500

2003 YOA:

Plant & Machinery:

I.A = 1200 x 50% = 600

A. A = $\frac{1200 - 600}{4}$ = 150

= $\underline{1,250}$ $\underline{1,400}$

Existing investment allowance = 1200 x 15% = 180

Notes:

1. As a rule, investment allowance cannot be carried forward; it must therefore be relieved as much as possible since the unrelieved balance will lapse.

2. Loss incurred during the pioneer period will be available for relief against the first post-pioneer period profit, thereafter the unrelieved balance will lapse.

3. Election provision rule under Sc 24(3) have been ignored.

4. Education and Corporation Tax cannot be computed because there was no available Total Profit for the relevant years of assessment.

3. Namu Glass sheets Ltd. Was granted pioneer status in 1993, which expired in 1996 and was not renewed. There was a loss of N136,000 certified by the Federal Board of Inland revenue Service (FBIRS) as at the end of the pioneer period. The cumulative costs of assets acquired by the company are as follows:

	N'000
Plant and machinery	85,000
Factory Building	575,000
Furniture and Fittings	60,000
Motor Vehicles	170,000

The company did not change its accounting year end which was 30th September. Recorded profit after the pioneer period where:

Net profit after charging depreciation	2,000,000
Depreciation	50,000

Ignore tax payer's right of election for second and third year of assessments. Namu Glass Sheet Ltd.

Computation of Corporation Tax for the relevant Years of Assessment

	N'000	**N'000**
Assessable Income Wk2		62,500
Pioneer Period Loss b/fwd	(136,000)	
Loss relief	62,500	(62,500)
Lapsed loss	73,500	
Total Profit		Nil
C.A wk3	264,000	

C.A Granted		Nil
C.A Lapsed	(13,000)	
C.A c/fwd	251,000	
Chargeable Profit		Nil
1997 YOA:		
Assessable Profit Wk2		250,000
C.A b/wd	251,000	
C.A b/fwd	104,000	
C.A for year wk3	104,000	
	355,000	
C.A Charged	(250,000	
(250,000)		
C.A c/fwd	105,000	
Total Profit		Nil
1998 YOA:		
Assessable income Wk. 2	250,000	
C.A b/fwd	105,000	
C.A for Year	104,000	
	219,000	
C. A Charged	(219,000)	219,000)
Total profit	31,000	
Corporation Tax @ 30%		9,300

Total Tax Due:	N
Education Tax (31,000 @ 2%)	620
Corporation Tax	9,300
	9,920

Workings

Wk1: Adjusted profit:	N
Profit per account	200,000
Add back depreciation	50,000
	250,000

Wk2: Computation of Assessable income

YOA:	Basis Period	A. I.
		N’000
1996	1/10/99-31/12/96	
	3/12 x 250,000	62,500
1997	1/10/96 – 30/09/97	250,000
1998	PYE 30/09/97	250,000

Wk. 3: Computation of Capital Allowance

QCE:	P/M	F/B	F/F	M/V	C.A
Rates: I.A%	50	15	25	50	
A.A%	25	10	20	25	

	N’000	N’000	N’000	N’000	N’000
Cost	85	575	60	170	
I.A	(43)	(86)	(15)	(85)	229
A.A	(3)	(12)	(2)	(5)	22
Investment Allow:	-	-	-		13
1997 YOA:TWDV	39	477	43	80	264
A.A	(13)	(53)	(11)	(27)	104
1998 YOA:	26	424	32	53	
A. A.	(13)	(53)	(11)	27)	104
TWDV c/fwd	13	371	21	26	

1996 **YOA:**

N’000

P/M I.A = 85 x 50% = 43

A.A = $\frac{85 - 43}{4} \times {}^{3}/_{12}$ = 3

F/B I.A = 575 x 15% = 86

A.A = $\frac{575 - 86}{10} \times {}^{3}/_{12}$ = 12

F/F I.A. = 60 x 25% = 15

A. A. = 60 – 15 x 3/12 = 2

5

M/V I.A = 170 x 50% = 85

A.A = 170 – 85 x 3/12 = 5

4

P/M Invest. Allow = 85 x 15% = 13

1997 YOA: N'000

P/M A. A =39 = 13

4-1

F/B A.A = 477 = 53

10-1

F/F A.A = 43 . = 11

10-1

M/V A.A = 80 = 27

4-1 104

Notes:

1. Observe the prorating of the annual allowance to agree with the basis period of 3 month of the commencement year of assessment.

2. Students are advised to always do the workings first, in the way the final tax computation becomes a matter of rules application.

Further Questions

1. Explain the meaning of pioneer legislation, its objectives and importance if any.

2. What are the conditions to be fulfilled before pioneer certificate can be granted by the Minister of Industry?

3. Under what circumstances an extension would be granted to a company before or after the expiration of a pioneer period?

4. Qualifying Capital expenditure acquired by a pioneer company must be certified by the Minister of Industry. How asset acquired before, during and after the pioneer period should be treated for purpose of capital allowance?

5. Discuss the treatment of profit or loss made by a company granted a pioneer certificate also how should the profit from unlisted or uncertified product and byproducts be treated?

6. Jayne Nigeria Ltd. Was incorporated on March 31, 1994 to manufacture a pioneer product. It was granted a pioneer certificate with a production day certified to be June 1, 1994. You are given the following information:

	N
Net profit for the year ended May 31, 1998	1,540,000
Depreciation charged for year ended May 31, 1998	132,145
Capital expenditure incurred up to and including year ended May 31, 1997 certified by the tax office are as follows:	
Motor Vehicles	1,250,000
Plant & Machinery	1,425,000
Industrial Buildings	1,890,000
Non industrial Buildings	920,000
Accumulated profit at May 31, 1997	725,000

It is not the intention of the directors to apply for an extension of the pioneer period.

You are required to compute the tax liabilities for the relevant years.

7. Mao Paul Limited was incorporated as a pioneer company on March 27, 1990 to manufacture nails. It was issued a pioneer certificate on November 1, 1991 with a production day given as July 1, 1991. The company's records showed the following information:

	N
Accumulated profit as at June 30 1994	330,000
Capital expenditure up to June 30, 1994 and certified by the FIRS:	
Plant and Machinery	521,000
Industrial Buildings	1,200,000
Non Industrial Buildings	235,000
Plantations	485,000
Motor	250,000

The trading result for type year ended June 30, 1995 showed a net profit of N2,450,000 after charging depreciation of N160,000 and withholding tax on rent included in expenses was N15,000.

You are required to compute the tax liabilities of the company for the relevant years of assessment, assuming that the company does not intend to elect.

MODULE 6

6.00 CAPITAL GAINS TAX

6.01 Learning Outcome

On successful completion of this Module, Student should be able to:

i. Appraise the basis of assessment of Capital Gain Tax;
ii. Identify the exemptions and reliefs available for capital gain tax purposes;
iii. Explain and interpret capital gain tax computations and losses;
iv. Discuss the meaning of indexation relief and how and who claims it;
v. Analyze capital gains on stocks, shares and quoted securities and how they are treated under the CGTA;
vi. Disintegrate between capital transaction of partnership and companies with other business transaction;
vii. Appraise the tax treatment of legatees and artificial transactions;
viii. Deconstruct the concept of connected persons and part disposal of assets treatments;
ix. Compute capital gain tax arising from takeover and line purchase transactions.

6.02 Bases of Assessment

Capital gain tax is tax on gains and profits made of disposal of assets. Consequently, the students must have knowledge of taxable persons liable to pay capital gains tax. The module begin by explaining the Basis of assessment and chargeable persons and cover exemptions and reliefs, computations of gains and losses, indexation relief capital gains tax as it applies to stocks, shares, and quoted companies tax treatment of legatees and artificial transactions.

The bases of assessment of CGT on chargeable gains on disposal of assets are assess to tax in the year in which the chargeable assets were disposed of. Chargeable persons other than company and non-president are required to file in any year of assessment; capital gain tax returns on any disposal with the relevant state internal revenue service while companies, nonresident individuals and resident of FCT are to file tax returns with the Federal Inland Revenue Service.

The current rate for CGT is 10% on chargeable gain payable as soon as the disposal of such chargeable capital assets is made. Where the tax payer fails to file returns, the relevant tax authority shall raise a Best of Judgment assessment. CGT assessment is expected to be paid within 60 days of the date of service of notice of assessment. Failure to pay attracts penalty at 10% per annum and interest at the ruling commercial rate.

Chargeable Assets

Section 3 of the capital Gain Tax Act CI, LFN 2004 as amended provides Inter alia - ”all form of property shall be assets for the purpose of this Act whether situated in Nigeria or not” including:

a. Any currency other than Nigeria currency
b. Options, debts and incorporeal property
c. Any form of property created by the person disposing it or otherwise coming to be owned without being acquired.

NOTE: Capital Gain Tax is chargeable on assets on which capital allowance are claimable in accordance with the PITA, CITA and PPT Acts.

6.03 Exemptions and Reliefs

Persons and Institutions Exempted from CGT

Section 26(1) of the Act exempted the following from CGT

a. Any statutory or registered friendly society.
b. Ecclesiastical, charitable or educational institutions of a public character.
c. Any trade union registered under the Trade Union Act. Provided:
   i. assets disposed are not used for other trade or business
   ii. Gains obtained are applied for the purpose of the society or union.
d. Any cooperative society registered under the cooperative societies law of any state.
e. organization formed under local government law
f. Companies formed for the purpose of promoting sports.

Assets Exempted From CGT

Section 28 to 42 of the Act exempted the following assets from tax on the capital gain arising from their disposal:

1. **Land disposed to an authority with compulsory power of acquisition:** No chargeable gain shall arise on the disposal of land to any authority with compulsory power of acquisition provided that:

   a. The owner of the land must not have taken such steps is to indicate his voluntary intention to sell.

   b. The owner of the land must have taken such steps as to ensure that the authority had not acquired the land before he acquired his interest.

2. **Private Resident or Dwelling House:** no chargeable gains shall arise on the disposal by a person of his only or main dwelling house. Where a person has more than one dwelling house, he is expected to inform the tax authority, which of the dwelling house is the main residence, failing on this, the tax authority will decide which of the house is the main residence. Where a private residence is partly occupied by the owner and partly let out, the capital gains arising from the disposal shall be prorated accordingly.

3. **Gift:** Assets acquired by way of gifts and disposed in similar manner shall not give rise to chargeable gains.

4. **Disposal of chattels:** No chargeable gain will arise on the disposal of chattels sold for N1,000 or less. However, where the sales proceeds is more than N1,000 the CGT payable shall be lower of:

   (a) (sales proceeds less cost) x CGT rate

   (b) Half of (sales proceed less N1,000) i.e. (sales proceeds – 1,000)/2

   Where there are more than one disposals by one person within the same tax year, the sale proceed shall be aggregated and exempted from tax accordingly.

5. **Decorations:** No chargeable gain shall arise on the disposal by a person of decorations award for valour or gallant conducts. For instance; national merit awards.

6. **Compensation from injury or damages suffered:** No chargeable gain shall arise from any sum received for injury or damages suffered by a person either to his person or in his profession for example; piracy, libel, slander, enticement.

7. **Compensation for loss of office:** No chargeable gin shall arise for any sum received as compensation for les of office.

8. **Shares and stock:** No chargeable gains shall arise from the acquisition of share or stock of any description of a company either through merger, takeover, and absorption of any other forms. If acquisition of a business as result of which the acquired company losses is identity as company provided that no cash payments is made in respect of shares acquired under merger.

9. **Life Assurance Policy:** No chargeable gain shall arise on the disposal of an interest in a life assurance policy provided the person disposing is the original beneficiary and acquired his interest either in consideration in money or money with.

10. **Nigerian currency:** No chargeable gain shall accrue from the disposal of Nigeria currency.

11. **Unit trust scheme:** No chargeable gain shall arise on disposal of an investment under any unit trust scheme provided the proceeds are reinvested.

12. **Disposal of interest in a superannuation fund:** No chargeable gains shall arise from the disposal of an interest in a superannuation fund of a retirement benefit scheme approved the joint tax board.

13. **Nigeria Government Securities:** Gains accrue from the disposal of Nigeria treasuring bills, premium bonds, saving certificates are not chargeable.

14. **Capital gain occurring to a diplomatic body.**

Note: However, that if any asset relating to the exempted institutions above and which is held on trust cease to be subject to such trust, any gain on disposal shall be liable to capital gain tax. In so far as the gain is not derived from any disposal of any assets acquired in connection with any trade or business carried on by the institution or society as the case may be (section 27(11)).

Disposition means any trust, grant, covenant, agreement or arrangement (section 21 (3s).

Transaction between connected person shall be deemed to be artificial or fictitious if in the opinion of the board, those transactions have not been made on terms which might fairly have been expected to have been made by persons engaged in the same or similar activities dealing with one another at arm's length (section 21 (3b).

In relation to any direction made under this section, this provision of the Act as to appeals against an assessment shall have effects as if such direction were an assessment (section 21 (3c))

Connected Persons

Section 23 of the Capital Gains Tax Act defined connected persons as:

a) A person is connected with an individual if that person is that individual's husband or wife, or is a relative, or the husband or wife of a relative, of individual or of the individual's husband or wife.

b) A person in his capacity as trustee of a settlement is a settle, and with any person who is connected with such an individual.

c) A person is connected with any person with whom he is in partnership, and with the husband and wife or a relative of any individual with whom he is in partnership.

d) A company is connected with another company:

i) If the same person has control of both, or a person has control of one and persons connected with him or he and the person connected with him have control of the other or

If a group of two or more persons has control of each company and the groups either consists of the same persons by treating (in one or more cases) a member of either group as replaced by persons with whom he is connected.

e. Any two or more persons acting together to secure or exercise control of a company shall be treated in relation to that company as connected with one another and with any person acting on the directions of any of them to secure or exercise control of the company.

Having covered our objective, let us now use a complex illustration to demonstrate them.

Treatment of Capital Losses

A capital loss arises from the disposal of capital assets if the proceed from the disposal is less than the cost the capital assets and allowable expenditure. Section 5, of capital Gain Tax ACT (CGTA) CAP CI LFN 2004 state that in the computation of chargeable gain. For CGT purpose, a loss made on the disposal of any asset shall not be deductible from gains made on the disposal of similar asset or any other asset.

Reliefs

- **Double Taxation Relief:**

Double taxation relief is applicable to CGT as it is applicable with the substitution of the wards ''capital gains for income and profits, and CGT for income tax''.

- **Delayed Remittance Relief:**

Section 42(1): A person charged or chargeable for any year of assessment in respect of chargeable gains accruing to him from the disposal of assets situated outside Nigeria may claim that the following provisions of this section shall apply on showing that:

i. he was unable to transfer these gains to Nigeria; and
ii. that the inability was due to the law of the country where the income arose, or to the executive action of its government, or the impossibility of obtaining foreign currency in that territory; and
iii. The inability was not due to any want of reasonable endeavors on his part.

Section 42(2) if he so claims, then for the purpose of capital gain tax:

i. there shall be deducted from the amount on which he is assessed to capital gain tax for the year in which the chargeable gains accrued to the claimant the amount as respects which the conditions in paragraphs (a), (b) an (c) of subsection (1) of this section are satisfied, so far as applicable, but
ii. The amount so deducted shall be assessed to capital gains tax on the claimant (or his personal representatives) as if it were an amount of chargeable gains accruing in the year of assessment in which the said conditions cease to be satisfied.

Section 42(3) no claim under this section shall be made on respect of any chargeable gain more than six years of assessment in which he might have made under this section if he had not died.

Assets Situated Outside Nigeria:

Where an asset situated outside Nigeria is disposed of, capital gains tax is chargeable on that part received or brought into Nigeria. A CGT will be charged on the gains if the individual is in Nigeria on temporary basis, if the disposal is made by a trustee of any trust or settlement whose seat of administration is outside Nigeria or by a non-Nigeria company (a company whose activities are managed and controlled outside Nigeria during the whole year of assessment) shall be charged on the amount received or brought into Nigeria in respect of CGT.

NOTE: There is no liability to tax if the gains are not received or brought into Nigeria.

Roll over Relief (section 32 CGTA)

If the consideration received on disposal of an old assets used only for the purposes of a trade is applied in acquiring a new asset in replacement to be used for the purposes of the same trade, and the old assets and the same one of the classes of assets listed in the Act, the person carrying on the trade shall, on making a claim as respects the consideration which has been so applied, be treated for CGTA purpose:

a. As if the consideration for the disposal of old assets were (if otherwise of a greater amount or value) of such amount as would secure that on the disposal neither a loss nor a gain accrues to him, and

b. As if the value of the consideration for the acquisition of the new assets were reduced by the excess of value of the actual consideration for the disposal of the old assets over the amount of the consideration which he is treated as receiving under paragraph (a) above.

The foreign will not have any effect on the parties to the transactions involving the old or new assets other than the purchaser of the old assets will still be treated as acquiring that asset at the price which he has paid for it.

Where an unconditional contract for the acquisition has been entered into this section may be applied on provisional bases without waiting to ascertain whether the new asset is acquired in pursuance of that contract. When the fact is ascertained, all necessary adjustment s shall be made by making additional assessments or by repayment or discharge of tax and shall be made not withstanding any limitation in the act on the time within assessments maybe made. The assets to which this section applies are classified as:

Class 1. Assets:

A. Land and building and any permanent or semi-permanent structure in the nature of a building, occupied as well as used only for the purposes of trade.

B. Fixed plant or machinery

Class 2. Assets -–----- ships

Class 3. Assets -------- Aircraft

Class 4. Assets -------- Goodwill

If over the period of ownership, or any substantial part of the period of ownership, a part of a building or structure is partly used for the purposes of a trade, this section shall apply as if the part so used is a separate assets it will be subject to any necessary apportionment for an acquisition or disposal (section 32(7).

This section shall apply in relation to a person who, either successively or at the same time, carries in two trades which are in different localities, but which are concerned with goods or services of the same kind, as if in relation to old assets used for the purposes of the other trade, the two trades we the same (section 32(9).

This section shall apply with necessary modifications in relation to a business, profession, vocation or employment as it applied in relation to a trade. The expressions “trade’’, ’’business’’, ’’profession’’, vocation’’, and ’’employment’’ have the same meanings as in the Income Tax Acts, but not so as to apply the circumstances in which, on a charge in the persons carrying on a trade is to be regarded as discontinued, or as set up and commenced (section 32(10).

Format for Computing Roll-over Relief

		N	**N**
Sales proceed of old asset			XX
Less cost of old assets		(X)	
Chargeable gains			XX
Less roll-over relief			
Amount reinvested	XX		
Less cost of old assets	(X)	(X)	
Chargeable gains rolled over		X	
Balance liable to capital gain			

CGT at 10%		X

Carrying Cost

	N
Actual cost of new assets	XX
Less chargeable gain rolled over	(X)
Carrying cost of the new assets	X

Steps for determining roll over relief

1. Compute the capital gains on disposal of the assets.
2. Compare the sales fixed on the disposal of the assets to the amount invested in the new asset acquired in replacement for the one disposed.
3. Choose the lower of the two
4. Deduct from step 3 above, the original cost of acquiring the asset disposed. This gives the amount rolled over.
5. The amount rolled over obtained in step 4 is deducted from the capital gains computed in step 1 above to determine the net capital gain.
6. Apply the relevant rate of tax on the net capital gain tax payable.
7. Compare the capital gain tax payable if the rate of tax were applied on step 1 above.

The following conclusion should be reached upon the comparison:

- **Full Roll-Over Relief:** Where no tax is payable after the relief is computed
- **Partial Roll-Over Relief:** Where only a portion of the tax computed per step 1 is immediately due.
- **No Roll-Over Relief:** Where the full amount computed per step 1 is immediately due.

Other types of capital gain tax relief and allowance are:

Indexation relief and tape allowance which are not claimable in Nigeria tax laws. We shall deal with this latter in this chapter**.**

Illustration 1:

Chief Akpos sold his factory plant which he acquired 8 years ago for N1,000,000.00. The cost of acquisition at that time was N200,000.00 He acquired a new factory plant for N1,500,000 to enable him carry on his business. Required determine the relief available to chief Akpos.

Solution 1:

For the purpose of capital gain tax, and upon chief Akpos making a claim, he will be treated,

a. As if neither a loss nor a gain accrues to him on the disposal, that is the proceeds of disposal will be taken to be equal to the cost which is N200,000.00 and therefore no capital gains tax is payable.

b. As if the cost of acquisition of the new assets (N1,500,000.00) where reduced by the excess of the actual proceeds of disposal of the old assets (N1,000,000.00) over the amount of the proceed which he is treated as receiving under (a) above (N200,000.00) that is N8,000,000.00 which would otherwise be the capital gain on the disposal of the old assets, will be deducted from the cost of the new asset.

Thus the cost of the new asset for CGT practice will be N750,000.00 (N1,500,000.00 – N800,000.00). This is referred to as roll over relief in the CGT practice. The liability to CGT on gains which have been fully reinvested in the same assets used for the same trade being deferred until the replacement asset is finally disposed. Note that where the insurance compensation money for loss or destruction of a capital asset is applied within three years of receipt in acquiring a replacement asset, the above shall also be applicable if the owner so claims(section 19)

Illustration 2:-

Assuming that in the illustration I above, Chief Akpos disposed of the plant for N1,200,000.00 with the acquisition cost of N500,000.00 and new factory plant was acquired to replace the old plant. The cost of the new plant is N1,080,000.00.

Required: Determine the relief available and carrying cost of the new plant?

Solution 2: **CHIEF AKPOS**

COMPUTATION OF ROLL OVER RELIEF 20X TAX YEAR.

		N(000)	N(000)
Sales Proceed		1,200	
Less cost of acquisition		500	
Capital gains		700	
Deduct lower of:			
a. Sales Proceed	1,200		
b. Amount Reinvested	1,080		
Less cost of acquisition	(500)		
Amount rolled over		580	
Net Capital gain		120	
Tax (LGT) at 10%		12	
Carrying Cost		N000	
Actual cost of new assets		1080	
Less chargeable gain rolled over		580	
Carrying cost of the new asset		500	

Loss Relief

Section 5 of CGTA Acct 2004 stipulates that in computation of chargeable gains for CGT purposes, the amount of any loss which accrues to a person on disposal of any asset shall not be deducted from gain accruing to any person on a disposal of such asset.

6.04 Computation of Capital Gain and Losses

The chargeable gain shall be the difference between the consideration accruing to any person on a disposal of assets and any sum to be excluded from that consideration and there shall be added to sum the amount of the value of any expenditure allowable to such person on such disposal. That is net proceed less allowable acquisition cost of that asset. Under section 14, the following gains are allowable as deduction from proceed when computing chargeable gain on disposal.

i. Cost of acquisition of the assets including any incidental cost upon acquisition where the asset is not required any expenditure wholly, exclusively and necessarily in providing the asset.

ii. Any expenditure incurred in establishing, preserving or defending the title to or right over that asset.

iii. The incidental cost of making the disposal.

iv. Any expenditure incurred for the purpose of enhancing the value of the assets and which is reflected in the state or nature of the asset at the time of the disposal

Note that: Any premium paid on insurance policy taken against risk of damage or injuries of assets disposed are not allowable – section 16.

Disposal: occurs when ownership changes or when owner divests himself of his right or interest over the property. The proceed on disposal to be used when computing the chargeable gain is either the actual consideration received or the market value whichever is higher. Where an asset is acquired by a creditor in satisfaction of his debt or part thereof, the asset shall not be treated as disposed of by the debtor or acquired by the creditor for a consideration greater than its market value at the time of the creditor acquisition of it.

Where an asset is given for another asset of lesser value, the transaction is assumed not be at arm's length and will be deemed to have been at the market value on the date of the exchange and tax will be paid on the computed chargeable gain. Similarly, the other party would also be deemed to have made his disposal at the prevailing market price at that time of exchange and would be liable to pay capital gain tax on chargeable gain.

Property Acquired as a Gift

When an asset is acquired as a gift or otherwise (not being on devolution on death) is disposed of as a gift, the person acquiring the asset on disposal is deemed to have acquired it for a consideration equal to the amount for which the asset was last disposed of by a way of bargain made at arm's length. In a scenario where the amount cannot be ascertained, the consideration shall be deemed to be equal to the market value of the asset on the date of that disposal.

Illustration 3

Eku Ltd donated a chargeable asset with a market value N450,000 to Ohoyakpo charitable organization. The company acquired the asset six years ago at the cost of N500,000.

The consideration for the acquisition of the asset by the charitable organization is N510,000 (the consideration for which the asset was last disposed of at arm's length).

However, if that amount cannot be ascertained, the consideration would be N450,000 (the market value of the assets as at the date of disposal as gift to Ohoyakpo charitable organization).

Chargeable Gain on Disposal of assets situated outside Nigeria

Where a disposal of such asset is made by an individual who is in Nigeria on temporary basis by a trustee of any trust or settlement whose seat of administration is outside Nigeria or by a non-Nigerian company that is a company whose activities are managed and controlled outside Nigeria during whole year of assessment, capital gain tax shall be charged on the amount (if any) received or brought into Nigeria in respect of any chargeable gains, such amount being treated as gains accruing when they are received or brought into Nigeria.

Chargeable gain on consideration due after time of disposal (Instalmental payment) section cap C1 LFN 2004.

Where the consideration or part of the consideration due on disposal of an asset is payable by installments over a period exceeding 18 months, the chargeable gain accruing on the disposal shall be regarded as accruing in proportionate parts in the year of assessment in which the disposal is made and in each of the subsequent years of assessment down to and including the year of assessment in which the last installment is payable. The proportionate parts to be recorded as accruing in the respective years of assessment, according to section 17(2) shall correspond to the proportions of the amounts of the installments payable in each of the years of assessment. This means that the gain accruing to any years of assessment is determined by applying a ratio of the amount of installment payable in that year over the total amount of installments involved in the transaction on the chargeable capital gain. The part of chargeable gain attributable to any year of assessment is deemed to accrue on the last day in that year of assessment section 17(5) provides that consideration for a disposal shall be brought into account without any discount for the postponement of the right to receive any part of it and in the first instance, without regard to a risk of any irrecoverable or to the right to receive part of the consideration being contingent. This means that the apportionment of chargeable gains to years of assessment should be based on the initial or original agreed pattern on training of installments. Where any part of the consideration so brought into account (that is even when the payment of the installment is postpone to future date or time but brought into account based on original timing) is subsequently shown to the satisfaction of the board to be irrecoverable, such adjustment, whether by way of discharge, or replacement of tax or otherwise, shall be made as is required in consequence.

Note; that section 17(1) will only be applicable if the period for the payment of the installments exceeds 18months. Thus all payments for installments including any initial deposit is treated as belonging to the assessment year in which the disposal is treated as belonging to the assessment year in which the disposal is made.

Format for computing capital Gain Tax	N
Sales proceed	XX
Less allowable expenses	(X)
Net sales proceed	XX
Deduct cost of acquisition	(X)
Capital gains	XX
Capital gain tax 10%	X

Steps in computing CGT

1. Identify the sales proceed on the disposal of the chargeable assets.
2. Deduct allowable expenses from the sales proceed to obtain the net sales proceed.
3. The cost of acquisition and other capital cost are then deducted from the Net sales proceed to obtain the capital gain.
4. Compute the capital gains tax liability by applying the capital gain tax rate of 10% on the capital gains obtains in step 3.

Steps in computation of capital gain payable by installment.

1. Compute the total capital gain as stated above.
2. Identify the dates that each installment is paid.
3. Identify the corresponding years of assessment that the dates of installment fall into.

4. Compute the chargeable gain for each installment using the relationship establish in step 3 above.
5. Compute the capital gain tax payable on each installment made for the relevant tax years by applying the relevant tax rate.

Illustration 4

Chinyere Nig. Ltd sold a plant to Bokoh Ltd for N1,000,000 in 1st February 2007. The terms of the disposal provided for 6 equal semi-annual installments payable with the first installment due on 1st March 2007. An initial deposit of N250,000 was paid on the day of the disposal. The plant was acquired from Paul & co ltd for N575,000. Chinyere Ltd incurred N60,000 for the dismantling of the plant during disposal. Bokoh Ltd made payment as follows

Initial deposition on 1/2/07	250,000
1st payment on 1/3/07	110,000
2nd Payment on 1/9/07	100,000
3rd Payment on 1/4/08	90,000
4th Payment on 1/11/08	90,000
5th Payment on 1/5/09	90,000
6th payment on 1/10/09	100,000
7th payment on 1/3/10	85,000
8th payment on 1/9/10	85,000

Required: compute the capital gain tax payable by Chinyere Ltd for the first three relevant years of assessment

Solution **CHINYERE NIG LTD**

COMPUTATION OF CAPITAL GAIN TAX

N000

Proceed on disposal	1000
Less dismantling expenses	60
Net proceed on disposal	940
Deduct	
Cost of acquisition	575
Total chargeable gain	365

Capital gain tax payable for 2007 years of assessment:

Amount due per original term of disposal:

Initial deposit 1/2/2007	250,000	
1st installment 1/3/2007	125,000	
2nd installment 1/9/2007	125,000	
3rd installment 1/3/2007	125,000	
		625,000

$$CGT = \frac{625}{1000} \times \frac{365}{1} = 228,125$$

CGT payable for 2008 YOA Amount due per original term of disposal:

4th installment 1/9/2008	125,000

$$\text{CGT payable } \frac{125,000}{1000,000} \times 365 = 45625$$

CGT payable for 2009 YOA

Amount due per original term of disposal

5th installment 1/3/2009	125,000
6th installment 1/9/2009	125,000

$$CGT = \frac{250,000}{1000000} \times 365 = 91250$$

(250,000 printed above the fraction line)

Note

1. Determination of amount and time of installment by original term of disposal

	N
Sales proceed/consideration agreed	1,000,000
Less initial deposit	250,000
Total payable in 6 installment	750,000
Amount payable per installment 75,000/6	125,000

2. Due dates 1st installment 1/3/2007

2nd installment 1/9/2007

3rd installment 1/3/2008

4th installment 1/9/2008

5th installment 1/3/2009

6th installment 1/9/2009

3. First year of assessment is 18 months

Part Disposal of Assets – Section 16

Where only a part of an asset is disposed of, cost relating to the disposed part shall be computed as follows:

a. Ascertain the proceed on disposal of the part disposed.

b. Determine the market value of the undisposed part. Then the cost attributable to disposed part is determined as follows: $\underline{A}$ x C

A+B

Where

A = The sales proceeds of part sold

B = The market value of part not sold

C = Cost of the whole asset

Note: Where the transaction is between connected persons and the market value is higher than sales proceed "A" shall be used as the market value of the asset.

If the unsold part is sold in later day, the cost shall be the total cost of acquisition less cost of already disposed part and add if any, the cost of improvement after the earlier disposal.

Illustration 5

Ohoga Nig Ltd in July 2013 sold part of the company's building at Okene, Kogi State for N10,000,000. The building which was acquired at the cost of N6,000,000 ten years ago. The market value of the remaining part of the building held by the company was N20,000,000 on 31st July, 2013.

Required:

Compute the CGT payable by Niger Nig ltd on the disposal of the asset.

Solution

Proceed from disposal		N10,000,000
Less cost of acquisition relating to disposal		

$$\frac{10,000,000}{10,000,000 + 20,000,000} \times 6,000,000 = \underline{2,000,000}$$

Total chargeable gain	8,000,000
CGT at 10%	800,000

6.05 Indexation Relief

Indexation relief otherwise called inflation allowance is an allowance which reduces the taxable gain on an investment by increasing its base. It is an adjustment on the effect inflation on the cost of chargeable assets.

It is argued that in an inflationary environment, indexation of capital gains is required to prevent the taxation of inflation gains that do not represent increase in real economic power. The argument is difficult to sustain on a theoretical level and almost impossible to sustain a practical level. It is true that inflation distorts the measurement of real gains. The adjustment is made by multiplying the relevant item of allowable expenditure by a factor, the multiplier. The multiplier to be applied depends on the year of assessment in which the expenditure was incurred and the year of assessment in which the disposal is made.

Indexation allowance is practiced in United Kingdom up to 2008 years of assessment. In the Nigerian tax system, there is no allowance for indexation or inflection relief and taper allowance. Hence it is not claimable in the against any capital gain for income tax in Nigeria; That no adjustment will be made to recognize the effect of inflection on the acquisition cost or chargeable gain under CGT Act 2004.

6.06 Capital Gains Tax as it Applies to Stocks, Shares and Quoted Securities:

Stock and share of every description disposed at gain, that such capital gains are chargeable to tax up to 31st December 1997. This means that such gains were exempted from capital gains tax effective from 1998 years of assessment.

Section 32A of capital gain tax Act 2004 provides that a person shall not be chargeable to tax under the Act, in respect of any gains arising from the acquisition of the shares a company, either merged with or taken over or absorbed by another company as a result of which the acquired company has lose its identity. However, where shareholders are either wholly or partly paid in cash for surrendering their shares in the ceased business, the gains arising from the cash payment will be subject to C

A. Property in Set:

Section 38(3) capital gain tax Act 2004 Cap C1 LFN 2004 states that where two or more assets formed part of a set of articles of any kind and all owned or bought at one time by one person are disposed by that person and to another person or persons in an arm’s length transaction whether on the same or different occasions, the two or more transaction shall be treated as a single transaction and the asset/property as single but with the necessary apportionments of the reduction in tax.

Illustration 6:

Dr. Oke Okih bought a set of furniture consisting of two units in Jan 2012 for a total cost of N20,000. He sold one unit of the furniture to Peter for N14,000 on 30th June 2013. On that date, the market value of the unit remaining unsold was N14,000. In March 2014, he sold the second unit for N13,000.

Required: Compute the capital gains tax payable

Note: The sales/disposal of the furniture is a case of partial disposal while the purchase is a case of property in set.

Solution **DR OKE OKIH**

COMPUTATION OF CAPITAL GAINS TAX PAYABLE FOR 2013 YEAR OF ASSESSMENT.

Sales proceeds of the first unit sold 14,000

Less cost attributable to the first unit sold

$$\frac{A}{A+B} \times C \qquad \frac{14{,}000}{14{,}000+14{,}000} \times 20{,}000 =$$

Capital Gain 10,000

Capital Gain Tax payable 4,000

10% of Capital Gain 400

Or

½ x (A+b – 1,000) = (28,000-1,000) /2 13,500

Whichever is lower

2014 YOA (Year of Assessment)

Sales proceeds of the last unit sold 13,000

Less cost of the last unit sold:

Total cost 20,000

Cost of last unit sold 10,000 (10,000)

Capital Gain	3,000
CGT payable (10% of 3,000)	300

Treating the two transaction as a single transaction.

Total sales proceed (14,000 + 13,000)	27,000
Less total cost of acquisition	(20,000)
Capital Gain	7,000
CGT payable:	
10% of capital Gain	700
or	
½ x (27,000 – 1,000)= ½ (26000)	13,000

Whichever is lower – apply CGT rate.

6.07 Treatment of Capital Gain of Partnership and Companies Transaction.

Capital gain and losses are treated differently from regular business transactions of individuals, partnerships and companies in Nigeria. Gains arising from the disposal of assets are taxed at the rate of 10%. Capital losses of partnership and companies cannot be charged against normal trading income but can be carried forward to offset future capital gains tax from the same source; such capital loss on disposal of asset is not deductible from capital gains on disposal of any other asset even if both are of the same type (Section 5).

In the usual income computation, profits or losses on disposal of fixed assets are excluded by means of adjustments to the relevant accounting results. At the same time balancing adjustments would be made in capital allowances computation in respect of the difference between the proceeds of disposal and tax written down value of such assets balancing allowance will be granted if the proceed falls short of the written down value and a balancing charge if the proceed is higher. In the latter case, if the proceed is greater than the cost, the amount of the balancing change would be restricted to the amount of capital allowances previously granted. This will be the difference between the cost of acquisition and tax written down value of disposal. In such a situation, another surplus, that is the difference between the proceed and the cost, which has not been subjected to any taxation treatment arises. In taxation laws and practice, all transactions of capital nature are excluded from income tax of companies and partnership. In view of the fact that the surplus referred to is a capital receipt, it cannot be included in profit or loss of any business for there is no liability to capital gains tax in respect of the disposals of those fixed assets.

6.08 Tax Treatment of Legatees and Artificial Transactions

Tax Treatment of Legatees/Death Section 8 CGT Act 2004

On the death of an individual, any assets of which he was competent to dispose of, shall for the purposes of the Act be deemed to be disposed of by him at the date of his death and acquired by the personal representatives or other person on whom the assets devolve for a consideration equal to.

(a) The amount of the consideration for which this asset was last disposed of by way of a bargain (see section 20) made of arm's length if ascertainable, or

(b) In any other case, the market value of the asset at that date (subsection1). The gains which accrue in consequence of subsection (1) of this section shall not be chargeable to capital gain tax under the act(subsection 2). The personal representatives shall be treated as having the deceased's residence and domicile at the date of death (subsection 3).

Person Acquiring Assets as Legatee:

a) No chargeable gain shall accrue to the personal representatives and

b) The legatee shall be treated as if the personal representative's acquisition of the asset had been his acquisition of it (subsection 4).

Legatee means any person acquiring an asset under a testamentary disposition or on an intestacy or partial intestacy whether he takes beneficially or as trustee and a donation mortis causa shall be treated as a testamentary disposition and net as a gift.

Personal Representatives means;

a) The executor, original or by representation or administrators for the time being of a deceased person under any law in force in Nigeria.

b) Persons having in relation to the deceased under the law of another country any functions corresponding to the functions for administration purposes under any law in force in Nigeria or personal representatives as defined under para (a) of this section, and references to personal representatives as such shall be construed as references to the personal representatives in their capacity as having such functions.

Tax Treatment for Artificial Transaction

Where the board is of the opinion that any disposition is an artificial or fictitious transaction or where any transaction which reduces or would reduce the amount of any capital gains tax is artificial or fictitious, the board shall disregard such disposition and may direct that such adjustments shall be made with respect to the liability of any person for the payment of capital gain tax as it considers appropriate so as to counteract the reduction of liability to capital gain tax effected or reduction which would otherwise be affected, by the transaction and any person concerned with such transaction shall be assessable accordingly (section 21(11).

Any person in respect of whom, any direction is made under this section shall have a right of appeal in like manner as though for the purposes of the Act such direction were an assessment to CGT (Section 21(2).

Other Capital Gain Tax Matters

Capital Gains Arising from Takeover

Gains arising from absorption, takeover or merger are exempted from capital gains tax provided cash does not form part of the consideration offered for the shares acquired. When cash is received as part of consideration, for settlement, the proportion of the gains attributable to the cash element of the consideration is taxable.

Note:

When the shares of a company are acquired, and such company is absorbed, taken over by or merged with another company, the gains from such transaction will not be subjected to tax provided:

- The acquired company losses its identity
- No cash payment for the shares involved and

- There is no disposal of such share by the original holders.

Illustration 7:

The shareholders of Jedeko sold the company to ISEE Plc. in exchange for N500,000 disposal value consisting of N220,000 cash and 120,000 ordinary share of N1 each values at N10 each. The assets of the business were revalued on the date of transfer as follow:

Items	Cost of Acquisitions N	Market value N
Freehold Premises	130,000	180,000
Plant and Machinery	165,000	205,000
Debtors		48,000
Furniture	55,000	65,000
Goodwill	-	30,000
Stock	102,000	97,000
Total		625,000
Less Creditors		125,000 500,000

Required: Compute the capital gains tax payable by Jedeko

Solution: **JEDEKO NIGERIA LTD.**

Computation of Capital Gains Tax Payable for 2013 Year of Assessment (YOA)

	Gains(N)
Freehold Premises (130,000 – 180,000	50,000
Plant and Machinery (165,000 – 205,000)	40,000
Furniture (55,000 – 65,000)	10,000

Goodwill	30,000
	130,000
Chargeable Gain $\frac{130,000}{500,000} \times 220,000$	57,200
Capital Gains Tax (10% x 57,200)	5,720

Note: The actual value realized from the sales of an in corporal property is taken to be capital gain e.g. Goodwill.

Capital Gain Tax on Hire Purchase Transaction

When an asset is sold on hire purchase, it is treated as full disposal at the beginning of the period the buyer/hirer obtain the use of the assets for the purpose of capital gain tax both in relation to the hirer/buyer and the seller.

Provision for necessary adjustment will be made by way of discharge or repayment of tax in case the hirer /buyer period of use of the assets terminate without the asset passing over to him.

In computing capital gains accruing on the disposal of an asset acquired on hire purchase and later disposed of the cost of the asset is used as the hire purchase prices.

The cost of hire purchase comprises of two elements, the hire purchase price and the hire purchase interest. In computing the capital gains for tax purposes, only the hire purchase price paid in installment that is regarded as the qualifying expenditure/cost for tax purpose while the hire purchase interest is ignored.

Illustration 8:

Erhiga Ltd purchased a vehicle on hire purchase on the 1st Jan 2012 on the following terms.

	N
Deposited on 1st Jan 2012	450,000
Monthly installments commencing on 1st Feb 2012	100,000
Interest element in each installment	10,000
Repayment period	2 years

On 30th June 2014, the company sold the vehicle for N3,500,000 inurning cost relating to the disposal of N35,000.

Required: Compute the capital gains tax payable by Erhiga Ltd.

Solution: **ERHIGA LTD**

COMPUTATION OF CAPITAL GAINS TAX PAYABLE FOR 2007 YEAR OF ASSESSMENT.

Sales Proceeds		3,5000,000
Less incidental cost of disposal	35,000	
Net sales proceeds	3,465,000	
Less:		
Cost of acquisition	2,610,000	
Capital gains	855,000	
Capital gains tax (10% x 855,000)	85,500	
Computation of cost of acquisition		
Initial deposit	450,000	
Installment (24 x 100,000)	2,400,000	
Hire purchase Price	2,850,000	
Less Hire Purchase Interest	240,000	
	2,610,000	

Illustration 9.

Palm estate ltd is an investment property company. The following transactions were carried out during the year ended 31st December 2013.

a. On 1st Feb, 2013 the company disposed one of its office building in Aba for N5,250,000. The tax written down value of the asset as at the time of disposal was N582,250. The asset was acquired for N3,150,000 8years ago. Before developing the property for office, N275,000 was incurred to put the building in commercial purpose. N26,500 was incurred annually as insurance cost of the building.

b. On 3rd March 2013, two out of the three warehouses acquired for N60,000,000 were disposed to two separate individuals for N84,500,000. One of the buyer who is the managers' son-in-law paid N41,000,000. Prior to the disposal, the estate valuer engaged by the company stated that the fair value of each bay was N45,000,000. The company incurred N325,000 as advert cost and 1.5% of the valuation was paid to the estate valuer. The third warehouse was sold on 7th of January 2014 for N45750,000.

c. An industrial plant purchased for N2,210,000 and cost N62,500 to install was disposed for N2,550,000 on 6th of April 2014. Five weeks before the disposal, a more efficient plant was acquired for N2750,000 and cost N65,000 to install, Another sound proof plant that was purchase for N675,000 was disposed for N875,000. After incurring advert cost of N6250. Three weeks later, a new model of the plant was acquired for N725,000.

d. A solar system equipment acquired N2,250,000 for residential use was considered unfit for the purpose and disposed for N2,000,000 Uriri and Voke Ltd on 8th April.

e. A six wing complex which cost N45,000,000 to construct was disposed for N90,000,000. Deposit of N20,000,000 was paid on 5th of march 2013 and the balance was agreed to be paid over four equal installment starting 1st June 2013.

Required: Determine the capital gains tax payable 1 deferred the carrying cost and the value for capital allowance for each of the transactions.

Solution : PALM ESTATE LTD:

Office Building	**N**	**N**
Sales proceed		5,250,000
Less T WDV (Tax written down value)		582,250
Balancing charge		4,667,750
Acquisition cost	3,150,000	
Improvement cost	275,000	

	3,425,000	
Initial allowance at 15%	(513,750)	
Annual allowance 10%(291125X8)	(2,329,000)	
Total capital allowance		(2,842,750)
Chargeable gain		1,825,000
CGT at 10%		182,500

Ware House	**2013**	
	N000	**N000**
Sales proceeds (willing buyer)	43,500	
Connected person (MKT Value)	43,500	87,000
Less advert cost	325	
Valuation fee (1.5%X90000)	1,350	(1,675)
		85,325

Less acquisition cost

$$\frac{87,000}{87,000 + 45,000} \times 60,000 \qquad 39,545.45$$

Chargeable gain	45,779.55
2014	**N 000**
Sales proceeds	45,750
Cost of acquisition 60,000-39,545.45	20,454.55
Chargeable gain	25,295.45

Industrial plant	**N000**	**N000**
Sales proceed		2,550

Cost of assets	2,210		
Installation cost	62.5		(2,272.5)
			277.5
Less Roll-Over Relief			
Amount Re-invested	2,550		
Cost of old Asset	2,272.5		277.5
Chargeable gain			Nil
Cost of new asset	2,815		
Chargeable gain rolled over	277.5		
Carrying cost	2,537.5		
Cost for capital allowance purpose		2,815	

Sale Profit Plant	**N**	**N**	
Sale proceeds	875,000		
Advert cost	(6,250)	868,750	
Less acquisition cost		(675,000)	
		193,750	
Less Rolled over Amount			
Re-invested	725,000		
Cost of old Assets	675,000		
Chargeable gain rolled over		(50,000)	
Chargeable gain		143,750	
CGT at 10%		14,375	

Solar System	**N**	**N**

Sales proceeds	2,000,000
Less acquisition cost	(2,250,000)
Capital loss	250,000

Complex	**N 000**	**N 000**
Sales proceeds		90,000
Acquisition cost		45,000
Chargeable gain		45,000

Payment

1/3/2013	deposit	20,000			
1/6/2013	1st installment	17,500			
1/12/2013	2nd Installment	17,500			
1/6/2014	3rd Installment	17,500	=	72,500	
1/12/2014	4th Installment	17,500	=	17,500	
					90,000

Capital gain tax payable

2013 Tax year (18 Months) N000

$\frac{72500}{90000}$ X 45,000 = 36,250

Capital gain tax at 10% 3,625

2014 Tax year N000

17500 X 45000 = 8,750

90000

CGTat 10%   875

Note that installment within 18 months of disposal as per original agreement will be chargeable in the 1st year of assessment.

Revision Questions

1. Explain the following terms

a. Roll over relief

b. Chargeable gain

c. Connected person

d. Indexation relief

2. Explain clearly, how capital transaction of business partnership and companies are treated under CGTA 2004.

3. a. What do you understand by the term ''legatees''?

b. What are the requirements of CGTA 2004 0n Artificial Transactions?

4. APC and PDP Ltd is a firm of contractors from whose books, the following transaction was extracted at 31st June 2013:

Cost of acquisition 1st July, 2012	N
Motor vehicle	1,400,000
Freehold plant & equipment	1,210,000
Generator	200,000
Disposals:	
Freehold plant & equipment	1,460,000
Generator	300,000

Re-acquisition: plant & equipment	1,560,000
Generator	180,000

You are required to determine:

a. chargeable gain

b. Roll over relief

c. Carrying cost and capital allowance available for 2013 tax year.

6.09 Review Questions

a. Discuss in details the Term ‘Chargeable Assets’
b. List the persons, assets and institutions exempted from Capital Gain Tax
c. Explain the concept of ‘Connected Persons’ in relation to Capital Gains Tax computations

MODULE 7

7.00 VALUE ADDED TAX

7.01 Learning outcome

On successful completion of this Module, Students should be able to

i. Examine the principles underlying the operation of Value Added Tax (VAT) in Nigeria;
ii. Evaluate the penalties and offences relating to VAT;
iii. Appraise the basic principles and application of VAT;
iv. Identify the goods and services that are taxable and chargeable.

7.02 Introduction

Value added tax is a topic that can be examined in the context of almost any income tax question. It is a tax on the production and consumption of goods and services which is borne by the final consumer but collected at each stage of the production and distribution chain. In this module, the purchases underlying the operations of VAT, Methods and bases of Assessment of VAT are examined. This will enable students have a very sound understanding of the whole issues behind VAT.

7.03 Principles Underlying the Operations of VAT

VAT is a tax payable on the goods and services consumed by any individual, business organization or government agencies. VAT is levied at each stage of supply or production. It is ultimately borne by the consumer who, not being registered for VAT purposes is unable to reclaim it.

7.04 Legislative Requirement and Procedure

VAT was introduced into Nigeria to replace sales tax following the recommendation of the study group set up by the federal government in 1991. VAT came into existence following the enactment of the Value Added Tax Act 102 of 1993 which repealed the sales Tax Act 1986. However, VAT became effective from 1st January 1994. The VAT Act was amended 2004 to become Value Added Tax Act Cap VI LFN 2004. VAT is chargeable at the rate of 5% on the supply of taxable goods and services except items specifically stated as exempt or zero-rated. VAT is administered by the Federal Inland Revenue Services.

a. Objection and Appeal

Where a tax payer is aggrieved by an assessment, the law allows such a tax payer to object and subsequently file an appeal before the VAT tribunal. The VAT tribunal is set up in 5 zones of the federation adjudicating on disputes between the taxpayer and the tax authority.

b. Vat Tribunal

This is a recent creation aimed at dissolution of issues or disputes between tax payer and tax authority. Five zonal tribunals have been created by the Federal Ministry of finance. Each Zonal Tribunal shall0 be made up of not more than 8 persons none of whom shall be a serving public servant. One of the members shall be the chairman who shall be a legal practitioner of not less than 15 years post call experience.

c. Contents of a Notice of Appeal

The notice of appeal against a VAT assessment must contain the following:

(a) The name and address of the taxable person

(b) Any tax input

(c) The net amount of tax payable

(d) The precise ground of appeal

(e) The total amount of goods and services chargeable to tax in respect of each month.

d. Offences and Penalties

S/N	SECTIONS	OFFENCES	PENALTY
1	Section 26	Participates in or takes steps with a view to, the evasion of tax by him or any other person	Liable on conviction to a fine of N30,000 or twice of the amount
2	Section 27	Failure to make attribution or notify the board	Liable to pay a penalty of

		of the attribution made	N5,000
3	Section 29	Failure to notify the Board of any change of address	Liable to pay a penalty of N5,000
4	Section 29	Failure to issue tax invoice for goods and service rendered	Liable on conviction to a fine of 50% of the cost of the goods and services
5	Section 30	Resists, hinders, or obstructs or attempts to resist authorized officer from carrying out inspection	Liable on conviction to a fine of N10,000 or imprisonment for a term of 6 months or both
6	Section 32	Failure of register	Liable on conviction to a fine of N5,000
7	Section 33	Failure to keep proper records and accounts	Liable to pay a penalty of N2,000 for every month
8	Section 34	Failure to collect tax	Liable to pay 150% of the amount not collect plus 5% interest above the CBN Re-discount rate.
9	Section 35	Failure to submit returns	Liable to a fine of N5,000 for every month in which the failure continues

e. Registration by Government Ministries Etc.

Section 9 provides that every Government Ministry, statutory body, and other agency of Government shall register as agents of the Board for the purpose of collection of VAT. Every contractor transacting business with a Government Ministry, statutory body, and other agency of the Federal, State or Local Government shall produce evidence of registration with the Board as a condition of obtaining contract.

f. Registration by Non-Resident Companies

Section 8B states that for the purpose of the VAT, a non-resident company that carries on business in Nigeria shall register for the tax with the Board, using the address of the person with whom it has a subsisting contract, as the address for purposes of correspondence relating to the tax. A nonresident company shall include the tax in it's invoice and the person to whom the goods or services are supplied in Nigeria shall remit the tax in the currency of the transaction.

7.05 Definition, Objectives and VAT Administration in Nigeria

VAT is administered and managed by the Federal Inland Revenue Service through VAT directorate. The Act allows the Board to do such things as it may deem necessary and expedient for the assessment and collection in accordance with the provisions of the VAT Act Cap VI, LFN, 2004.

Section 21 of the VAT Act provides for the establishment of a technical committee known as the Value Added Tax Technical Committee. The committee is composed of the following members.

(a) A chairman who shall be the chairman of the FIRS.

(b) All Directors in FIRS.

(c) The legal adviser to the FIRS.

(d) A Director in the Nigeria custom service.

(e) Three representatives of the State Government who shall be members of the Joint Tax Board.

7.5.1 The Functions of the VAT Technical Committee

(i) To consider all tax matters that requires professional and technical expertise and make recommendations to the Board.

(ii) To advise the Board (Service) on the assessment and collection of VAT.

(iii) To attend to such other matters as the Board (Service) may from time to time referred to it.

Taxable Goods and Services

The tax shall be charged and payable on the supply of all the goods and services other than those goods and services listed in the schedule to VAT Act as exempted.

Goods and Services Exempted from VAT

A. Goods Exempt:

(i) All medical and pharmaceutical products

(ii) Basic food items like beans, yam, rice, etc.

(iii) Books and educational materials

(iv) Baby products

(v) Commercial vehicles and their spare parts

(vi) Agricultural equipment and products and veterinary

(vii) All exports

(viii) Plants and machinery used in export processing zone.

(ix) Fertilizers, farming machinery etc.

(x) Plant and machinery and equipment purchased for utilization of gas in downstream petroleum operations.

(xi) Tractors, ploughs, etc. for agricultural products.

B. Services Exempt:

(i) Medical Services

(ii) All exported services

(iii) Services rendered by community banks, people's bank and mortgage institutions.

(iv) Plays and performances conducted by educational institutions as part of learning.

VAT Revenue Distribution

Section 36 of VAT Act of 2004 states that, notwithstanding any formula that may be prescribed by any other law, the revenue accruing from VAT shall be distributed as follows:

(a) 15% to the Federal Government.

(b) 50% to the State Government and the Federal Capital Territory Abuja and

(c) 35% to the Local Government.

This sharing formula took effect from 1st January 1999. Between 1994 and 1999, the revenue from VAT was shared amongst the three tiers of government in Nigeria as thus:

	1994	1995	1996 and 1997	1998
Federal Government	20%	50%	35%	25%
State Government	80%	25%	40%	45%
Local Government	-	25%	25%	30%

Tax Invoice

Section 11A VAT (amendment) No 12, 2007 states that a VAT-able person who makes a taxable supply shall in respect of that supply, furnish the purchases with a tax invoice containing inter alia the following:

(a) Tax payers identification number (TIN)

(b) Name and address

(c) VAT registration number

(d) The date of supply

(e) Name of purchaser or client

(f) Gross amount of transaction

(g) Tax charged and rate applied

Returns and Remission of Tax

Section 15 of VAT Act as amended of Act No 12 of 2007, a taxable person shall render to the Board on or before 21st day of the month following that in which the purchase or supply was made. A person who imports taxable goods into Nigeria shall render to the Board returns on all the taxable goods imported by him into Nigeria.

On remission of tax, section 16 of VAT Act LFN 2004, provides that a taxable person shall on rendering a return make remittances as follows:

(a) If the output tax exceeds the input tax, remit the excess to the Board or

(b) If the input tax exceeds the output tax, be entitled to a refund of the excess tax from the Board on production of such documents as the Board may from time to time require.

7.06 Accounting for VAT

A. VAT Exclusive and VAT Inclusive

VAT Exclusive: This occur when the VAT element is not hidden in the price or value of goods and services but is separately disclosed in the invoice or receipt VAT inclusive: Where the VAT element is subsumed or hidden in the price of goods and services stated on the invoice without being separately disclose, we say the price is VAT inclusive

Illustration 1

Awe received supply from two different manufacturers the same day. The first supply worth N220,000 VAT exclusive and the second supply worth N180,000 VAT inclusive.

Required: Determine the value of goods supplied (net of VAT)

Solution:

Step I: Determine the value of VAT

Step II: Add the VAT to the cost of the goods supplied

- VAT Rate 5%

Supply 1: VAT amount = 220,000 X 5% = 11,000

Add: VAT amount to the original cost of the article supplied 11,000 + 220,000 = N23,000

Note: The value of the article – 231,000 is the combination of the price plus VAT.

Supply II: If the price of the supply is N180,000 VAT inclusive, it means that VAT is wrapped up in the price quoted. Therefore, VAT can be ascertained using the

Formula:

$$\frac{\text{VAT Rate}}{100 + \text{VAT Rate}} = \frac{0.05}{1.05} \times 180{,}000 = 8{,}571$$

Price of article = 171,429

B. VAT and foreign goods

International trade allows VAT to be imposed on goods in the country in which they are produced or in the country in which they are consumed. The Principle of Origin and Destination applies in this case.

The Principle of Origin: This principle allows VAT to be imposed on goods in the country in which they are produced rather than consumed. This principle is practiced in Balarus. In Balarus, VAT is levied on goods produced for export at the country VAT rate.

The Principle of Destination: This principle allows VAT to be levied on goods and services in the country where they are consumed rather than produce. Nigeria operates this VAT principle; VAT is levied on the goods and services imported into the country.

Where the VAT is inclusive, VAT payable on an item is calculated as 5/105 X price of the item or service. Where the VAT is not inclusive, VAT payable on an item is calculated as 5/100 X price of the item or service.

Illustration 2:

Total value of VAT-able suppliers/sales during the month of January 2013 was N220,000. Total value of VAT-able purchase and expenses during same period was N178,000.

Required: Compute the VAT payable by the business in the month of February.

NOTE: All the amounts are VAT inclusive.

Solution: Computation of VAT liability

Output tax = 5/105 X N220,000 = N10,476

Less: Input tax = 5/105 X N178,000 = N8,476

VAT payable to FIRS = N2,000

Illustration 3:

In 2013, a VAT-able product was sold to the final consumer for N250,000. This product initially moved from raw materials to a manufacturer at N100,000. The finished goods were sold to a wholesaler at N150,000 and later to a retailer at N200,000.

Required: Compute

(i) Total output tax

(ii) Total input tax

(iii) Total VAT payable to the government

(Adapted from ICAN 2001)

Solution: (i) Computation of total output VAT

		N
Value of sales		250,000
VAT Output at 5%		12,500

(ii) Computation of Total input tax

Cost of Raw Material	100,000	
VAT input at 5%	5,000	

(iii) Computation of VAT payable for 2013 Tax year

Total output tax	12,500	
Less total input tax	(5000)	
VAT payable		7,500

7.07 Vat-able Persons and Zero-Rated Items

Vat able Person is one who deals on Vat able goods and services. Anyone who trades on vat-able goods and services for consideration is a vat able person. This includes

(i) A sole trader

(ii) A professional e.g. Accountant, Lawyer etc.

(iii) A partnership

(iv) A limited liability company

(v) A club or association

Specifically, they are persons who independently carryout in any place any economic activities such as:

(a) Producer/manufacturer

(b) Wholesaler

(c) Importers

(d) Supplier of goods etc.

Zero-rated Goods and Services

The following goods and services are vat able at zero-rate:

(i) Non-oil exports

(ii) Goods and services purchased for diplomats

(iii) Goods and services for use in humanitarian donor funded project.

7.08 Review Questions

Question 1:

Value Added Tax (VAT) is a form of indirect taxation introduced by the Federal Inland Revenue Service. Discuss **(ICAN 2000).**

Question 2:

Compute the VAT payable to government on a product that moves from Raw materials producer

(a) To manufacturer

(b) At N25,000; then to wholesaler

(c) At N30,000; then to retailer

(d) At N45,000; and finally to the consumer

(e) Who pays N60,000 to the retailer

Question 3:

The following transactions were carried out by Jedeko Nig. Ltd in the month of April, 2014.

Purchase of PMS	11,600
Cost of AGO	7,200
Cost of DPK	3,600
Purchase of Lubes	920
Total oil	420
Grease	4,300
Purchase of motor vehicle	8,250
Sales of PMS	12,000
Sales of AGO	8,500
Sales of DPK	4,100
Sales of Lubes	1,150
Sales of Grease	4,100
Sales of Total Oil	120
Stock as at 30th April, 2014	
PMS	180
AGO	210
Grease	470
Total Oil	500

Required: Ascertain the VAT liability/payment for the month of May, 2014

Question 4:

a. Discuss the principles underlying the operations of VAT
b. What are the contents of a notice of appeal under VAT?
c. List the various offences and penalties under VAT
d. Identify the organs administration and the composition of the VAT Technical Committee in Nigeria
e. List the Good and services exempted from VAT

MODULE 8

8.00 TAXATION OF SPECIALIZED COMPANIES OR TRANSACTION

8.01 Learning outcome

At the end of this Module, Students should be able to:

i. Examine the special provisions of CITA regarding the taxation of non-Nigerian shipping or air transport companies and compute the tax liabilities of such companies.

ii. Evaluate special provisions of CITA regarding the taxation of insurance companies and compute the tax liabilities of such companies.

8.02 Introduction

Taxation of special companies is a topic that can be examined in the context of almost any income tax question. In this module, the general issues concerning air/sea transportation, insurance companies, banks, unit schemes and gambling are examined. This will enable the students to have a sound understanding of the issues behind taxation of specialized companies.

8.03 Taxation of Air/Sea Transport

The business of air and sea transportation is very special in-nature. A ship that left Nigeria sea port on a given day may stay there till six months or more outside Nigerian shores before returning back to the same port. The return of a ship back to Nigerian port will depend on the availability of cargo and passenger it has for the Nigeria trip.

However, what makes them special is the fact that the company may apply to the Federal Inland Revenue Service to be subject to tax using two ratios.

A. Non-Nigerian Company

Section 21(1) of CITA Cap C21, LFN 2004 as amended and consolidated provides that: where a Non Nigerian-company carries on the business of transport by seal air, and any ship or aircraft owned or chartered by it calls at any port or airport in Nigeria, its profits or loss to be deemed to be derived from Nigeria shall be the full-profits or loss arising from the carriage of passengers, mails, livestock or goods shipped, or loaded into an aircraft, in Nigeria except where the goods etc. are brought to Nigeria solely for transshipment of for transfer from one aircraft to another or in either direction between an average and a ship.

Section 14(2) provides where a country tax assessment and computation are similar the same to that of Nigeria, the profit or loses chargeable in Nigeria shall be computed by applying the percentage ratio of profit or loss before depreciation to the total income receivable in respect of the carriage of mails, passenger, livestock or goods and deducting there from, capital allowance, ratio of depreciation to the total sums receivable in respect of the carriage of passengers etc. out of Nigeria

DETERMINATION OF TAXABLE INCOME.

Format:

Adjusted Profit Receivable in Nigeria	XXX	
Less		
Capital allowance (using depreciation ratio or actual)	(X)	
Total Taxable Income		XX

Steps:

1. Determine the amount of income derived in Nigeria from the carriage of mails, passenger, livestock or goods out of Niger*i*a.
2. Determine all income generated from other sources.
3. Determine the total adjusted profit for the period (Total Income less allowance expenses).
4. Calculate the depreciation charge for the period.
5. Calculate the adjusted profit ratio as follows:

$$\frac{\text{Adjusted Profit}}{\text{Total Income from all sources}} \times \frac{100}{1}$$

6. Ascertain the Depreciation Ratio

$$\frac{\text{Depreciation Charge}}{\text{Total Income from all source}} \times \frac{100}{1}$$

7. Calculate the adjusted profit receivable in Nigeria by applying the adjusted profit ratio in(5) above to the income derived in Nigeria (1) above, that is;

Adjusted Profit Ratio x Income derived in Nigeria

8. Determine the capital allowance by applying the depreciation ratio in (6) above on the total amount derived in Nigeria (1) above, that is;

Depreciation Ratio x Income derived in Nigeria

9. Taxable profit for the relevant assessment year is determined by subtracting adjusted profit from capital allowance.

10. The tax liability is computed by applying the prevailing tax rate to the total taxable profit, 30% of taxable profit (a) above.

Illustration 1:

Airiko Airway Ltd a Ghanaian air transport company made up its account to 30th June 2010. The following was extracted from the books of account.

	N	**N**
Freight into Nigeria		82,465,200
Freight out of Nigeria		45,234,600
Freight to other routes		118,475,900
		246,175,700
Less: Expenses		
Allowable	121,607,600	
Depreciation	23,416,100	145,023,700
Net Profit		101,152,000

Required: Compute the tax liability of Airiko Airway Ltd in Nigeria for2011 assessment year.

Solution: **AIRIKO AIRWAY LTD**

COMPUTATION OF TAX LIABILITY FOR 2011 ASSESSMENT YEAR

		N
Adjusted profit (5)		22,888,708
Less: Capital Allowance (6)		(4,301,810)
Taxable income		18,586,898
Tax liability (7)	5,576,069	
Minimum tax (2)		904,692

The Income tax payable is N5,576,069 because it is higher than minimum tax N904,692

Workings:

1. Income Derived in Nigeria 45,234,600 while total Income is 246,175,700
2. Determination of Adjusted Profit:

Net Profit for the year	101,152,000	
Add Depreciation		23, 416,100
Adjusted profit		124,568,100

3. Determination of Adjusted profit Ratio

$$\frac{\text{Adjusted Profit}}{\text{Total Income from all source}} \times \frac{100}{1} = \frac{124,568,000}{246,175,700} \times 100 = 50.6\%$$

4. Determination of Depreciation Ratio:

$$\frac{\text{Depreciation charge for the year}}{\text{Total Income from all source}} \times \frac{100}{1} \quad \frac{23,416,100}{246,175,700} \times \frac{100}{1} = 9.51\%$$

5. Determination of Adjusted profit Receivable in Nigeria

=Adjusted Profit Ration x Income derived in Nigeria

=50.6% x 45,234,600 = 22,888,708

6. Determination of capital Allowance

Depreciation Ratio x Income Derived in Nigeria

9.51% x 45, 234,600 = 4,301,810

7. Prevailing tax rate is 30%= 30% 18,586,898 = 5,576,069

8. Minimum tax payable is 2% of income derived in Nigeria

2% of 45,234,600

=904,692

Illustration 2

I See International Airway ltd a Cameroon Airline makes its profit and loss account for the year ended 31st Dec 2012 as follows.

		N
Income from passenger freight to Nigeria		225,000
Income from passenger freight out of Nigeria		235,000
Income from goods loaded into aircraft in Nigeria		165,000
Income from goods loaded into Aircraft on other routes		275,000
		900,000
Less: Depreciation	190,000	
Salaries and other expenses	500,000	
Other disallowable expenses	40,000	730,000
Net Profit for the year		170,000

Additional Information

1. Salary and other Expenses Included:

a. Payment of N25,000 to Nigeria Airport Authority

b. Payment of N10,000 as rent for accommodation used as transit flat by the airline officials

c. Payment of N50,000 for routine repairs and aircraft serving

d. Capital expenditure N60,000

2. The Nigeria tax authority has agreed to allow the company to claim the amount of N170,606 as capital allowance.

Required: Compute the tax liability in Nigeria

Solution: **See International Airways Ltd**

Computation of tax liability for 2013 Assessment year

Adjusted Profit Received in Nigeria	208,000
Less:	
Capital allowance	170,606
Taxable Income	37,394
Tax liability	11,218
Minimum tax	8,000
Education tax	4160

The Income tax payable is N11,218 higher than the minimum value of N8,000.

Workings:

1. Income derived in Nigeria = 235,000 + 165,000 = 400,000
2. Determination of adjusted profit

Net profit		170,000	
Add:	Depreciation		190,000
	Disallowable expenses		40,000
	Rent		10,000

Capital expenditure		60,000
Adjusted profit	470,000	

1. Adjusted Profit Receivable in Nigeria

52% x 400,000 = 208,000

2. Adjusted Profit Ratio = $\frac{\text{Adjusted Profit}}{\text{Total Income}} \times 100$

$$\frac{470{,}000}{900{,}000} \times 100 = 52\%$$

3. Minimum tax = 2% of income receivable in Nigeria (400,000) = 8,000
4. Education tax = 2% of Adjusted profit (208,000) = 4160
5. Tax liability = 30% of taxable Income (37,394) = 11,218

8.04 Taxation of Insurance Company

Insurance business involves the transfer of risk of loss from one entity to another in exchange for payment (premium). Section 16(1) CITA 2004 LFN deals with the taxation of insurance companies. The Act classified insurance business into two categories:

i. Life Assurance business
ii. Non-life insurance businesses.

The difference between the life assurance business and non-life insurance business for tax purpose is that in life assurance business the premium received does not form part of income for tax purposes even under an endowment policy. Since the premium does not form part of the income, claims are not tax deductible. For Non-life insurance, the premium paid form part of income and the claim also is subject to tax.

However, from 1995, a company engage in composite insurance business (life and non-life insurance business) is taxed separately. This means that life assurance will be taxed and life insurance will be taxed separately such that any loss in one source cannot be relieved by the other source.

Insurance company like every other company, treats dividends received as Franked Investment Income, there are tax exempted.

Life Assurance Business

A. Nigerian Life Assurance Company: Section 16(5b) of CITA 2004 amended prescribed the criteria for the determination of taxable profit in the year of assessment. According to the section, the taxable profit shall be:

a. Investment Income

b. Actuarial Revaluation Surplus

c. Deduct;

i. General Reserves

ii. Transfer during the year

iii. Allowable management and Administrative expenses

d. Add: Balancing charge (If any) and;

Deduct unrelieved losses (if any) and Capital allowances.

e. Tax payable shall be the higher of:

i. 20% of cross income in that year of assessment or;

ii. 30% of the total profit as computed.

Note**:** The Investment Income includes Dividend (exempted from tax), annuities, commission received from the assured.

Format:

Investment Income	XX
Actuarial Revaluation Surplus distributed	XX
Other Income	XX
Gross Income	XXX
Deduct:	

i. General Reserve		XX		
Transfer during the year	XX			
Less Net liabilities on polices	XX			
Special Reserve	(X)	X		
The higher of				
1% Gross premium	X			
10% Net profit	X		X	
Allowable management expenses	X		(X)	
Assessable Profit			XX	
Less Capital Allowance			(X)	
Total Profit			X	
Tax payable: Higher of				
30% of total profit or				
20% of Gross Income				

Note: The transfer to special Reserve depend whether the minimum statutory paid up capital is equal to or less than the total Reserve.

B. Non Nigeria Assurance Company

The assessable profit of a non-Nigeria company whose income accrue in part outside Nigeria, the profit of such company shall be taxed in proportion to the total investment income of premium received in Nigeria less management expenses and other allowable expenses. This means that company's investment income taxable shall be that which accrue in Nigeria within the period under received.

An insurance company is liable to tax when the company carries out a business through a branch management or in a fixed place, but this does not include an agency in Nigeria unless the agent has and habitually exercises a general authority to negotiate and enter contracts on behalf of such company.

The investment income in Nigeria is determined by:

$$= \frac{\text{Premium Received in Nigeria}}{\text{Global Premium Received by Company.}} \times \text{Global Investment Income}$$

Non-life Insurance Company

Nigeria Company: Section 16(1) CITA LFN 2004, provides that the tax payable by a Nigeria Insurance Company whose profit accrues in Nigeria or part outside Nigeria shall be ascertain by:

a. Taking the gross premium, interest and other income receivable in Nigeria less any company.

b. Deduct Reserve for un expired risk using a percentage adopted by the industry at the end of the period for which the profit is ascertain and add reserve for unexpired risks outstanding at the beginning of the period.

c. Add reserve for unexpired risk outstanding at the beginning of the period and Deduct Reserve for unexpired risks using an industry adopted percentage at the end of the period subject to:

    i. In case of marine cargo -25% of total premium

    ii. In the case of general insurance business other then marine business -45% of total premium.

d. Add Balancing charge (if any) and Deduct unrelieved Losses (if any) and Capital allowance.

e. Deduct claims and outgoings of the company (expenses) restricted to 25% of total premium in the year.

f. Tax payable shall be higher of:

30% of total profit or

15% of gross income in that year of assessment.

Format:	N	N	N
Gross Premium		XX	
Less Premium to Re-insurance		(X)	

Net premium			XX
Add Interest Income		X	
Other Income		X	X
Gross Income			XX
Less: Provision for unexpired risk		X	
Add: Restricted to 45% of total premium for General business			
25% of total premium for marine cargo		X	(X)
Less Allowance Expenses:			
Claims	X		
Commission	X		
Management Expenses	X		
Agency Expenses	X		
Proportion of head office expenses	X		(X)
Assessment Profit			XX
Less unrelieved loss b/f			(X)
Capital allowance			XX
Adjusted profit			XX

Tax payable shall be higher of

Tax paid as per adjusted profit

Tax paid on 15% of Gross profit

Note: The proportion of head office expenses relating to non-Nigeria tax authority approves the amount in relation to that every year.

Illustration 1:

Boaska Insurance Plc. which had been in business for several years in Nigeria make up its account every 31st Dec. Details of the company transaction for the year ended 2013 were:

	2013	2012
Non-life Insurance Revenue	3,517,840	5,190,970
Life assurance	220,000	115,000
Investment and other Income	24,621,880	7,987,740
Provision for doubtful balance	(11,386,670)	(1,987,740)
Adm Expenses	(9,138,190)	(4,879,950)
Profit before tax	7,834,860	6,426,020
Tax	(2,350,450)	(1,927,800)
Profit after tax	5,484,410	4,498,220

Non-life Insurance Revenue Account 2013

	Marine	Motor vehicle	Accident	Fire	Total
Gross premium	5,935,550	6,288,580	7,455,750	20,671,750	40,351,630
Premium Ceded	(1,187,110)	----	(1,863,930)	(5,167,930)	(8,218,970)
Net Premium	4,748,440	6,288,580	5,591,820	15,503,820	32,132,660)
Reserve for unexpired Risk	(1,602,500)	(1,886,570)	(3,504,200)	(9,715,720)	(16,708,990)
	314,594	4,402,010	2,087,620	5,788,100	15,423,670
Claim Recoveries	623,110	-------	970,100	2,184,300	3,777,510
Claim paid	(1,602,590)	(2,012,340)	(1,148,200)	(3,472,860)	(8,235,990)
Underwriting	(1,095,470)	(1,166320)	(1,376,060)	(3,815,200)	(3,447350)

Expenses					
	1,070,990	1,229,050	533,460	684,340	3,517,840

Life Assurance	2013	2012
Premium Income	12,401,330	6,367,820
Premium Cede	(3,650,000)	(1,151,600)
Net Premium	8,751,330	5,216,220
Claim Recoveries	430,370	270,510
Claim paid	(4,448,770)	(1,239,980)
Commission	(2,890,200)	(1,330,740)
	1,843,730	2,916,010
Transfer to special Reserve	(184,373)	(291,600)
Transfer to profit and loss A/C	(220,000)	(115,000)
Transfer to life fund	1,439,360	2,509,410

8Investment and other Income:

		2008		2007
		Life	Nonlife	Total
Gains on the disposal of investment property		9,751,290	-	-
Security and stock	475,650	1,517,310	267,940	
Rental income	2,268,400	4,457,040	1,020,180	
Commission	-	3,189,090	461,110	
Franked Invest. Income	71,570	694,050	99,570	
Interest on fixed Deposit	893,940	1,180,880	108,360	
Profit on Disposal of fixed assets	-	122,660	30,580	

	13,460,860	11,161,030	1,987,740

Provision for Doubtful Debts	2013		2012
	Life	Nonlife	Total
Re-insurance Debtors	-	4,065,750	3,575,750
Bad Debts written off	1,673,350	460,000	718,300
Diminution in value of Invest	3,110,170	958,220	2,710,580
Other receivable	-	1,119,180	983,110
	4,783,520	6,603,150	7,987,740

Adm Expenses	2013		2012	
	Life	Nonlife	Life	Nonlife
Depreciation	644,830	2,089,630	426,330	900,750
Mgt Expenses	1,899,320	3241,250	652,860	1,928,950
Adult fee	250,000		200,000	
Staff cost	663,170		492,660	
Director`s Remuneration	344,830		278,400	
Exchange loss	5,160		-	
	9,138,190		4,879,950	

Additional Information

i. The total capital allowance is N6,638,180

ii. One third of the cost below relates to life business

Audit fee

Director`s remuneration

Staff cost

Capital allowance

Required: Determine the tax liability for life and non-life insurance business for 2014 tax.

Solution: **BOASKA INSURANCE PLC**

COMPUTATION OF LIFE ASSURANCE TAX LIABILITY FOR 2014 TAX YEAR.

		N	**N**
Transfer to profit & loss (Actuarial surplus)		220,000	
Gains from sales of Investment property		9,751,290	
Rental Income		2,268,400	
Interest on fixed deposit		893,940	13,133,630
Less Transfer to Reserves			
General Reserve life fund	4,718,350		
Transfer during the year	1,439,360		
	6,157,710		
Less Net liabilities on actuarial policy in force	6,037,710		120,000
Special Reserves: Higher of			
1% of Gross Premium	124,010		
10% of Net Profit	755,240		755,240
Allowable expenses			
Management expenses	1,899,320		
Audit fee	83,330		
IT levy of 1% of profit b/4 tax	75,520		
Direction Remuneration	114,940		

Staff Cost	221,060		
Bad Debt written off	1,673,350	4,067,520	
			4,942,760
Assessable Profit			8,190,870
Less capital allowance	2,212,727		2,212,727
Total profit			5,978,143
Tax Payable			
Income tax at 30% of total profit	1,793,443		
Minimum Tax	1,551,731		
Education Tax at 2% of Assessment profit	163,810		
IT levy at 1% of profit before tax	75,520		

Workings:

Minimum Tax

Gross premium	12,401,330	
Interest & other income	13,460,860	25,862,190
20% as total profit		5,172,438
Minimum tax at 30%		1,551,731

Non-life Insurance Business

Gross premium	40,351,630
Premium	(8,218,970)
	32,132,660

Investment and other income

Rental income	4,457,040

Commission	3,189,090		
Interest on fixed deposit	1,180,880		8,827,010
			40,959,670
Less			
i. Provision for unexpired risk:			
Marine Business restricted to 25% gross Premium		1,483,888	
General Business restricted to 45% Gross premium		15,106,490	16,590,378
Less			
Allowance expenses			
Claims paid		8,235,990	
Deduct recovered		(3,777,510)	
		4,458,480	
Under writing Expenses		7,447,350	
Bad Debt written off		460,000	
Management expenses		3,241,250	
Re-insurance Debtor		4,065,750	
Audit fee		166,667	
Director Remuneration		229,887	
Staff cost		442,113	
IT levy		19,062	
		20,539,559	
Restricted to Gross Premium		10,087,908	10,442,652
			27,033,030

Assessable Profit			13,926,640
Less capital allowance		(4,425,453)	
Total profit			9,501,187
Tax payable: Income Tax @30% of total profit	2,850,356		
Minimum tax	2,850,356		
Education tax @2% of assessment profit	540,661		
IT levy			19,062

8.05 Taxation of Banks

Banks like other companies are subject to company income tax payable under CITA as amended. In addition to the income tax payable, a special levy of 10% on excess profit was introduced in 1979 assessment year. The special levy rate was increase form 10% to 15% in 1989 but was however abolished with effect from 1991 assessment year.

Excess profit here means difference between total profit and the standard or normal estimated profit. Standard profit according to section 29(3) is the addition of the amount arrived at after applying an approved percentage to the amount of capital employed at the end of the accounting period as follows:

General Reserves	20%
Statutory Reserves	20%
Long-term loan	20%
Paid-up Capital	40% Or N6 million whichever is higher.

Note: In determining the standard profit, the Net Profit for that year is not included as part of general reserve. In a case where statutory reserve is different from Capital Reserve, either should be used in computing the normal profit.

Tax Exemptions of Certain Interests Received by Banks

a. **Loan for Local Plant and Tools:** Interest earned by banks on loan granted to a company engaged in the fabrication of local plant machinery and tools shall be exempted from tax if at least 18 months moratorium is allowed and the interest rate is not more than the lending rate base at the time the loan was granted. Base rate is the weighted average cost of found to the bank.

b. **Loan for Manufacturing Goods for Export:** Interest earned by banks on loan granted for the purpose of manufacturing goods for export shall be exempted from tax as provided in Table2,schedule3 CITA Cap 11(5) 2007 LFN, subject to two conditions:

i. The bank shall present a certificate issued by the Nigeria Export Promotion Council stating that the level of export specified had been achieved by the company.

ii. The beneficiary company must export not less than 50% of the goods manufactured and such goods are not re-exported to Nigeria.

A company is deemed to be engaged in manufacturing for export if the Nigeria Export Promotion Council certified it for that purpose.

c. **Loan For Agricultural Business:** Section 11(2) of 2007(amended) stipulates that interest on loan granted by banks to a company engaged in Agriculture shall be exempted from tare if at least 18 months moratorium is allowed and the interest rate on the loan is not more than the base lending rate at the time the loan is obtain. Agricultural business is defined by the Act as:

i. The cultivation or production of cereals crops, tubers, fruits, cotton, beans, groundnut, sheanuts, vegetable and plantain;

ii. Animal husbandry, poultry, piggery, cattle rearing, fish rearing and deep fish trawling.

iii. Plantation for production of rubber, oil palm, cocoa, tea or similar products.

The above sections also apply to loan for local plant and tools; loan for cottage industry.

Illustration 1:

Echi Int. Bank Ltd makes up its accounts to Dec 31st annually. The following information was extracted from the balance sheet of the Bank for the year ended 31st Dec 2010.

	N
Non-Current Assets	35,000,000
Current Assets	60,000,000
Total Assets	95,000,000

Share Capital		10,000,000
Statutory Reserve		5,000,000
General Reserve		5,000,000
Long term loan		5,000,000
Current liabilities		70,000,000
Total liabilities	95,000,000	

Additional Information:

i. The turnover of the year ended 31st Dec, 2010 was N20,000,000.

ii. Adjusted profit for 2011 year of assessment was N72,000.

iii. Unrelieved loss brought forward from 2008 is N12,000 while unutilized capital allowance brought forward from 2010 year of assessment was N20,000.

iv. Capital allowance for the 2011 year of assessment was N30,000. This excludes a balancing charge of N8,000 for the same year of assessment

v. Gross Profit was N2,000,000.

Solution: **ECHI INT. BANK LTD**

COMPUTATION OF TAX LIABILITY FOR 2009 ASSESSMENT YEAR.

			N
Assessable Profit			72,000
Add Balancing charge			8,000
			80,000
Less	Unrelieved Loss		12,000
			68,000
Less	Capital Allowance		
	Unutilized C.A $^{b}/_{d}$	20,000	

For the year		30,000	
		50,000	
Maximum 66$^{2}/_{3}$ of assessable profit		(48,000)	48,000
Unutilized Capital Allowed $^{c}/_{d}$	2,000		
Chargeable Profit			20,000
Income tax liability at 30% of chargeable profit			6000

Minimum tax:

i. 0.5% of Net Asset 20,000,000 = 100,000

ii. 0.5% of Gross Profit of 2,000,000 = 10,000

iii. 0.25% of the turnover of 20,000,000 = 50,000

iv. 0.25% of paid up capital 10,000,000 = 25,000

The highest of i-iv (Net Asset) 100,000

Add 0.215% of N20,000,000 - N50,000 = N24937.5

N124937.5

Education tax 2% of assessable profit 1,440

Note: The minimum tax of N124937.5 is more than the income tax liability of N6000.

Workings:

Net Assets = Total – Liabilities (95,000,000-75,000,000)= 20,000,000

Note: The minimum tare was calculated as prescribed in section 33(2) of CITA Cap C21 LFN 200

8.06 Taxation of Unit Trust Scheme

A unit trust scheme is established for the purpose of providing facilities for the participation of the public as beneficiaries under a trust, in profits or income arising from the acquisition, holding, management or disposal of securities or any other property whatever.

Accounting Treatment And Determination Of Taxable Profit

	N		N	
Investment income	X			
Other taxable incomes	______	X	______	X
Deduct: Trust managers remuneration	X			
Management expenses	X			
Other allowable expenses	X		(X)	
Adjusted profit			XX	
Less capital allowance	X			
Relieved	(X)		(X)	
Taxable profit			XXX	

8.07 Taxation of Gambling Betting Or Lottery Winning

Gambling betting like CASINO is governed by Casino Licensing Act of 1964. It is a tax on the net gaming revenue thereof to be known as Casino revenue tax and payable by the licensee as provided in the Act.

Assessment

Section 2 of the Act provided that tax shall be twelve and one half percent (12½%) of such revenue, and a license to operate a Casino shall be granted only to a company having such purpose as it's main object and duly registered and incorporated in Nigeria under the companies and Allied matters Act of 2011 LFN as amended.

A. Lottery Winnings

The Lagos State Lotteries Board (LSLB) is unique in Nigeria. It has a pioneer status in the country as a lottery regulatory body. The board was established by the Lagos State lotteries law Cap L89 2004 laws of Lagos State. They are saddled with responsibilities aimed at regulation of lotteries, promotional competition, and gaming activities within Lagos State.

8.08 Review Questions

a. Comment on the taxation of a Unit Trust Scheme as per the provisions of section 14A CITA 1979 as amended to date.

b. Identify the special provisions of CITA regarding the taxation of non-Nigerian shipping or air transport companies and compute the tax liabilities of such companies (iii) Total VAT payable to the government.

c. What are the steps to be taken in the determination of taxable income for a Non-Nigerian company?

9.00 PETROLEUM PROFIT TAX

9.01 Learning Objectives

At the end of this Module, Students should be able to:

i. Examine how petroleum profit tax is administered and how to deal with the tax authorities in connection with the tax.
ii. Appraise the nature and classification of production cost in the upstream sector of the petroleum industry
iii. Compute adjusted profits of companies engaged in crude oil prospecting and production.
iv. Analyze the principles underlying allowable and non-allowable deductions as applicable to petroleum profit tax.
v. Compute capital allowances for petroleum profit tax purposes.
vi. Elucidate the concept of memorandum of understanding (MOU) as applicable to companies engaged in the utilization of associated gas.
vii. Prepare petroleum profit tax computations in accordance to PPTA and MOUs.

9.02 Introduction

Module 8 represents a rigorous exposure of the student to concepts computation techniques, principles and practice of crude oil prospecting and production companies in the upstream sector in the Nigeria Petroleum industry. The module begin with the definition of assessable profits and chargeable profits in the petroleum industry and departs from that basis to nominal treatment of loses, double taxation relief, and acquisition, MOUs, deferred taxation; gas incentives objectives and uses and the implications of Joint Venture Contract. In this module students discover tax concepts and treatments that are different from that of trading or manufacturing companies or companies operating in the downstream sector.

9.03 Definition of Assessable Profits and Changeable Profit

Section 8 of PPTA provides that there shall be levied upon the profits of each accounting period of any company engaged in petroleum operations during that period, a tax to be charged, assessed and payable in accordance with the provisions of the Act. Companies taxable under the Companies Income Tax Act are assessable to tax on preceding year basis. For example, if a company usually prepares it accounts to 31st December, the profits for the accounting year ended 31st December, 2010 is taxable in 2011 year of assessment and the basis period if 1/1/2010 – 31/12/2010. On the other hand, profits arising from petroleum operations are assessable to tax on current or actual year basis under the provisions of PPTA. For example, petroleum profits for the accounting period ended 31st December, 2010 is taxable in 2010 year of assessment and the basis period is 1/1/2010-31/12/2010. In other words, in the accounting year and the year of assessment are the same.

Example

A Company engaged in petroleum operations commenced a sale or bulk disposal of chargeable oil under a programme of continuous production and sales on 1st September, 2007 and ceased operation on 30th April, 2011.

Required: State all the relevant years of assessment and accounting periods.

Solution

The relevant years of assessment and accounting periods are as follows:

Year of Assessment	Accounting Period
2007 (year of commencement)	1/9/07 – 31/12/07
2007 (2nd year)	1/1/08 – 31/12/08
2009 (3rd year)	1/1/09 – 31/12/09
2010 (4th year)	1/1/10 – 31/12/10
2011 (year of cessation)	1/1/11 – 30/04/11

Profit of an Accounting Period

The profit of an accounting period of a company engaged in petroleum operations is the aggregate of:

(a) The proceeds of sales of all chargeable oil sold by the company in that period;

(b) The value of all chargeable oil disposed of by the company in that period; and

(c) The value of all chargeable natural gas in that period; and

(d) All income of the company of that period incidental to and arising from one or more of its petroleum operations [PPTA 2004, s. 9(1)]

Value of any chargeable oil so disposed of

In respect of 3.2 (b) above, section 9(2) of PPTA 2004 provides that the value of any chargeable oil so disposed of is taken to be the aggregate of:

(i) The value of that oil as determined for the purpose of royalty in accordance with the provisions of any enactment applicable thereto and any financial agreement or arrangement between the Federal Government of Nigeria and the oil producing company;

(ii) Any cost of extraction of that oil deducted in determining its value; and

(iii) Any cost incurred by the company in transporting and storage of that oil between the field of production and place of disposal.

Value of chargeable natural gas

For the purposes of 3.2 (c) above, the Fourth Schedule to PPTA states that the value of all chargeable natural gas in the accounting period shall be the sum of gross proceeds under individual gas sales contracts in the accounting period less the **G-Factor Allowance** as applicable to individual gas sales contract at the appropriate rate per cent of such proceeds under any such individual gas sales contracts as specified in the table to the Schedule.

Table of G-Factor Allowance

Load Factor	G-Factor per centum	
	50	16.9
	60	15.5
	70	14.3
	80	13.6

Factors in between the figures stated in the table are calculated on a pro-rata basis. **G-Factor** means gas production cost adjustment factor.

The Government of the federation may from time to time review the G-Factor allowance specified in the table to the Schedule.

Example

The natural gas sold by Island Petroleum Company Ltd during 2016 came from two contracts as follows:

Contract	Value(N)	Load Factor
A	5,000,000	70^{O}
B	8,000,000	56^{O}

Required: Calculate the value of gas sold for tax purposes.

Solution:

Contract A	**N**
Value of contract	5,000,000
Less G-Factor allowance (14.3% x 5,000,000)	715,000
Taxable value of gas sold	4,285,000

Contract B

The table for G-factor allowance does not have a G-factor for 56^{O}, therefore, the factor for 56^{O} must be calculated on a pro-rata basis as follows:

$$16.9 - \left[(16.9 - 15.5) \times \frac{56 - 50}{60-50}\right]$$

$= 16.9 - (1.4 \times 6/10)$

$= 16.9 - 0.84$

$= 16.06\%$

	N
Value of contract	8,000,000
Less G-factor allowance (16.06% x 8,000,000)	1,284,800
Taxable value of gas sold	6,715,200

Determination of Adjusted Profit

The adjusted profit of an accounting period is the profit of that period after the deduction of allowable expenses and any adjustments necessary to exclude any profit or loss attributable to the transportation of chargeable oil by ocean going oil tankers operated by or on behalf of the company from Nigeria to another territory.

Exclusion of certain profits

Activities in the petroleum industry are divided into two broad categories: upstream and downstream. Profits from petroleum operations (i.e. upstream activities) are included in the adjusted profit and are subject to tax under PPTA. Profits from downstream activities are excluded from adjusted profit and are assessable to tax under CITA. Section 12 of PPTA specifically states.

Where a company engaged in petroleum operations is engaged in the transportation of chargeable oil by ocean going oil tankers operated by or on behalf of the company from Nigeria to another territory then such adjustment shall be made in computing an adjusted profit or a loss as shall have the effect of excluding there from any profit or loss attribution to such transportation.

Assessable Profit

The assessable profit of an accounting period is the adjusted profit of that period after the deduction of loss relief available to the company.

Chargeable Profit

The chargeable profit of an accounting period is the assessable profit of that period after the deduction of capital allowances.

The above stated points can be summarized as follows:

Proceeds of sales of chargeable oil	x	
Value of chargeable oil disposed of	x	
Value of chargeable natural gas	x	
Incidental income from petroleum operations	x	
Profit of an accounting period		xxxx
Less allowable expenses attributable to		

Petroleum operations	x
Adjusted profit	xxx
Less loss relief	x
Assessable profit	xx
Less capital allowances	x
Chargeable profit	x

9.03.2 Deductions Allowed (Allowable Expenses)

In order to ascertain the adjusted profit of any company for any accounting period from its petroleum operations, PPTA allows the deduction of outgoings and expense "wholly, exclusively and necessarily" incurred, whether within or outside Nigeria, during that period by the company for the purpose of those operations. The following expenses are specified in section 10(1) of PPTA 2004 as allowable deductions:

(a) Rents incurred by the company for that period in respect of land or buildings occupied under an oil prospecting license or an oil mining lease for the disturbance of surface rights or any other like disturbance;

(b) All non-productive rents, the liability for which was incurred by the company during that period;

(c) All royalties, the liability for which was incurred by the company during that period in respect of natural gas sold and actually delivered to the Nigerian National Petroleum Corporation, or sold to any other buyer or customer or disposed of in any other commercial manner;

(d) All royalties, the liability for which was incurred by the company during that period in respect of crude oil or casing head petroleum spirit won in Nigeria.

(e) All sums the liability for which was incurred by the company to the Federal Government of Nigeria during that period by way of customs and excise duty or other like charges levied in respect of machineries, equipment and goods used in the company's petroleum operations;

(f) Sums incurred by way of interest upon any money borrowed by such company, where the FIRS is satisfied that the interest was payable on capital employed in carrying on its petroleum operations;

(g) All sums incurred by way of interest on any inter-company loans obtained under terms prevailing in the open market, that is, the London Inter-Bank Offer Rate, by companies that engage in crude oil production operations in the Nigerian oil industry;

(h) Any expenses incurred for repairs of premises, plant, machinery or fixtures employed for the purpose of carrying on petroleum operations or for renewal, repairs, or alteration of any implements, utensils or articles so employed;

(i) Debts directly incurred to the company and proved to the satisfaction of the FIRS to have become bad and doubtful in the accounting period for which the adjusted profit is being ascertained notwithstanding that such bad or doubtful debts were due and payable prior to the commencement of that period:

Provided that:

(i) The deduction to be made in respect of a doubtful debt shall not exceed the portion of the debt which is proved to have become doubtful during that accounting period, nor in respect of any particular debt shall it include any amount deducted in determining the adjusted profit of a previous accounting period;

(ii) All sums recovered by the company during that accounting period on account of amounts previously deducted in respect of bad or doubtful debts shall be treated as income of that company of that period; and

(iii) It is proved to the satisfaction of the FIRS that the debts in respect of which a deduction is claimed were either-

- Included as a profit from the carrying on of petroleum operations in the accounting period in which they were incurred; or
- Advances made in the normal course of carrying on of petroleum operations not being advances on account of any disallowable expenses;

(j) Any other expenditure, including tangible costs directly incurred in connection with drilling and appraisal of development well, but excluding expenditure which is qualifying expenditure for the purpose of capital allowances, and any expense or deduction in respect of a liability incurred which is deductible under any other provisions of this section:

(i) Any expenditure directly incurred in connection with exploration, drilling and the drilling of the first two appraisal wells in a particular field, including expenditure in respect of cement and casing of well fixtures;

(ii) Where a deduction may be given under this section in respect of any such expenditure that expenditure shall not be treated as qualifying drilling expenditure for the purpose of capital allowances;

(k) Any contribution to a pension, provident or other society, scheme or fund which may be approved, with or without retrospective effect, by the FIRS subject to such general conditions or particular conditions in the case of any such society, scheme or fund as the FIRS may prescribe: Provided that any sum company, from any approved pension, provident, or other society, scheme or fund, in any accounting period of that company shall be treated as income of that company of that accounting period;

(l) All sums, the liability of which was incurred by the company during that period to the Federal Government or to any State or Local Government Council in Nigeria by way or duty, customs and excise duties, stamp duties, education tax, tax (other than the tax imposed by this Act) or any other rate, fee or other like charges;

(m) Such other deductions as may be prescribed by any rule made under this Act.

Notes

Paragraphs (b), (e) and (g) were included in section 10(1) with effect from 1st January, 1999. In respect of (k), note that under the Pension Reform Act 2004 the National Pension Commission is responsible for regulating supervising and ensuring the effective administration of pension matters in Nigeria and not the FIRS or the Joint Tax Board.

Waiver or Refund of Liability or Expense

Where a deduction has been allowed to a company in respect of any liability or expense incurred by that company and the whole or part of the liability or expense is later waived or released or refunded to the company, the amount of that liability or expense which is waived, released or refunded, as the case may be, shall be treated as income of the company of its accounting period in which such waiver, release or refund was made or given.

9.03.3 Deductions not allowed (Disallowable Expenses)

The following expenses are specifically listed in section 13(1) of PPTA 2004 as deductions not allowed in computing the adjusted profit of any company for any accounting period from its petroleum operations:

(a) Any disbursements or expenses not being wholly and exclusively laid out or expended, or any liability not being a liability wholly or exclusively incurred, for the purpose of those operations;

(b) Any capital withdrawn or any sum employed or intended to be employed as capital;

(c) Any capital employed in improvement as distinct from repairs; any sum recoverable under an insurance or contract of indemnity;

(d) Any sum recoverable under any insurance or contract of indemnity;

(e) Rent or cost repair to any premises or part of any premises not incurred for the purpose of those operations;

(f) Any amount incurred in respect of any income tax, profit tax, or similar tax whether charged within Nigeria or elsewhere;

(g) The depreciation of any premises, buildings, structures, works of a permanent nature, plant, machinery or fixtures;

(h) Any payment to any provident, savings, widows, orphans or other society, scheme or fund except such payments are allowed under section 10 of the Act;

(i) Any customs duty on goods (including articles or any other things) imported by the company.

(i) For resale or for personal consumption of employees of the company, or

(ii) Where goods of the same quality to those so imported are produced in Nigeria and are available, at the time the imported goods were ordered by the company for sale to the public at price less or equivalent to the cost to the company of the imported goods;

(j) Any expenditure for the purchase of information relating to the existence and to the extent of petroleum deposits.

(k)

9.03.4 Interests on Inter-Group Borrowings

Under section 13(2) of PPTA 2004, no deduction is allowed in respect of interest on money borrowed where such money was borrowed from a second company if during that period:

(a) Either company has an interest in the other company; or

(b) Both have interests in another company either directly or through other companies; or

(c) Both are subsidiaries of another company.

For the purposes of section 13(2):

(a) A company shall be deemed to be a subsidiary of another company if and so long as an interest in it is held by that other company either directly or through any other company or companies;

(b) An interest means beneficial interest in issued share capital (by whatever name called); and

(c) The FIRS shall disregard any such last-mentioned interest in their opinion is insignificant or remote, or where in their opinion that interest arises from a normal market investment and the companies concerned have no other dealings or connection between each other [PPTA 2004, s. 13(3)].

There seems to be a contradiction between sections 10(1)(g) and 13(2). Section 13(2) disallows interests on inter-group borrowings. On the other hand, interests on inter-company loans obtained under terms prevailing in the open market (i.e. London Inter-Bank Offer Rate) are allowable deductions under section 10(1)(g) with effect from 1999.

Donations

Under the Companies Income Tax Act, donations made by companies not engaged in petroleum operations to approved funds, bodies and institutions are allowable deductions. On the other hand, the Petroleum Profits Tax Act is silent on donations made by companies engaged in petroleum operations. This silence could be interpreted to mean that such donations are not allowable deductions. Nevertheless, donations made by companies engaged in petroleum operations may be allowed if the companies can prove to the satisfaction of the Federal Inland Revenue Service that such donations were wholly, exclusively and necessarily incurred for the purposes of petroleum operations.

9.04 Types of Contract Agreements in the Oil and Gas Industry

9.04.1 Joint Venture

Joint Venture is a contractual arrangement whereby two or more parties undertake an economic activity which is subject to contractually agreed basis of sharing of control.

Companies producing crude oil in Nigeria are not allowed to produce the oil solely on their own. Each company is required to enter into a Joint Venture Agreement with the Nigerian National Petroleum Corporation (NNPC) in respect of the company's operation in a particular oil field. A detailed joint venture operating agreement will be entered into by the parties. The agreement will spell out in detail the rights and obligations of each party with respect to the particular venture.

NNPC will usually take up a majority of the venture while the oil producing company will take up the balance. One of the parties to the venture is given the responsibility to operate the venture, that is, the production of crude oil from the concession that is the subject of the venture. This is the operator. The operator is the party that conducts the operations under a joint venture. This may include the drilling of a well and/or the production of oil from a tract or field under an agreed contract. In all or most of the cases, in spite of NNPC majority shareholding, it is the oil producing company that is appointed as field operator of the joint venture.

Each party to the joint venture is expected to fund its equity share in the venture. This is done when the operator makes calls for the needed cash (Cash Calls). Each party also lifts crude oil, from the crude oil produced, in proportion to its equity interest in the joint venture. When NNPC is unable to lift all its share of the crude produced, the field operator will under special arrangement with NNPC, lift the balance, sell it and pass the proceeds of sale to NNPC. Each joint venture agreement will make provision for an Operating Committee to oversee the preparation and approval of budgets and operational plans that would be prepared by the field operator.

Each party accounts for and pays its petroleum profits tax liabilities arising from the venture.

9.04.2 Production Sharing Contracts

In Production Sharing Contracts (PSC), the petroleum producing companies enter into agreement with NNPC for the production of crude oil in particular oil fields respectively. The operating expenses for the petroleum operations would be met by each operator. This is a major shift from the terms in Joint Venture Contracts. In case of joint venture, NNPC will fund the operational expenses of the venture in proportion to its share in the joint venture, but in respect of PSC's, the petroleum producing company will fund 100% of the contract. The provision for the reimbursement of costs to the operator in executing the contract will be contained in the PSC. This is usually achieved through the allocation to the operator of a proportion of the oil produced from which the company is expected to recover its cost of producing the oil and of executing the contract generally.

Oil recovered in the contract area is split into

(i) Royalty Oil

(ii) Cost Oil

(iii) Tax Oil

(iv) Profit Oil

Business activities under PSC are subject to tax under the Petroleum Profits Tax Act and the Deep Offshore and Inland Basin Production Sharing Contracts Decree No 9 of 1999. The Decree requires that the tax computation is done by the Petroleum Profits Tax to the Revenue. This is slightly contradictory to the relevant provision of PPTA. PPTA provides for persons engaged in petroleum operations to prepare tax returns, submit same and pay the PPT due. The responsibility for the payment of PPT is clearly stated in PPT. it is less clear in the Deep Offshore and Inland Basin Production Sharing Contract.

The key provisions of the Deep Offshore and Inland Basin Production Sharing Contracts Decree 1999 are:

(i) That the Petroleum Profits applicable to the contract area shall be 50% flat rate of chargeable profits for the duration of the Production Sharing Contracts.

(ii) That in respect of any qualifying capital expenditure incurred wholly, exclusively and necessarily for the purposes of the petroleum operations carried out under the terms of a Production Sharing Contract in the Deep Offshore or Inland Basin, there shall be due to the parties-

(a) In respect of Production Sharing Contracts executed prior to 1 July, 1998, an Investment Tax Credit at a flat rate of 50 per cent of the qualifying expenditure;

(b) In respect of Production Sharing Contracts executed after 1 July, 1998 there shall be due to such Parties an Investment Tax Allowance at a flat rate of 50 per cent.

(iii)	In both cases, royalty is payable as follows:	Rate
(a)	In areas from 201 to 500 metres water depth	12%
(b)	From 501 to 800 metres water depth	8%
(c)	From 801 to 1000 metres water depth	4%
(d)	In areas in excess of 1000 metres water depth	0%
(e)	The royalty payable in respect of Inland Basin shall be	10%

(iv) Computation and payment of estimated and final petroleum profits tax shall be made in US dollars on the basis of the US dollar returns filled.

(v) The Corporation or the Holder, as the case may be shall pay royalty, concession rentals and petroleum profits tax on behalf of itself and the Contractor out of the allocated royalty oil and tax oil.

(vi) Separate tax receipts in the names of the Corporation or the Holder and the Contractor for the respective amounts of the petroleum profits tax paid on behalf of the Corporation or the Holder and Contractor shall be issued by the Federal Inland Revenue Service in accordance with the terms of the Production Sharing Contract.

(viii) The chargeable tax on petroleum operations I the contract area under the Production Sharing Contracts shall be split between the Corporation or the Holder and the Contractor in the same ratio as the split of profit oil as defined in the Production Sharing Contract between them.

(i) **Sole Risk:** There is no special agreement between the operator and the government other than the granting of lease license (OML, OPL). The operator bears all the risks, pays royalty on production and Petroleum Profit Tax on its profit. These operators are mostly the indigenous companies.

(ii) **Service Contract:** Here, NNPC holds all concessions, on behalf of government; an operator is invited to carry out oil operations on a block of oil or oilfield and shares the oil profit with the NNPC in a manner enshrined in the service contract agreement. In this case, the contractor is taxed under Companies Income Tax Act and not under Petroleum Profits Tax Act.

9..05 Treatment of Losses in Petroleum Profit Tax Computations (section 14)

To arrive at the assessable profits, there shall be deducted from the adjusted profits:

(a) The amount of any loss incurred by the company during the previous accounting period;

(ii) For a new company, the amount of any loss incurred during its first accounting period in its trade or business.

Losses that cannot be fully deducted in any one period can be carried forward to the next succeeding accounting periods until fully relieved. The four years' time limit for the carry forward of trade loss under CITA and PITA is not applicable to losses incurred in petroleum operations as there is no provision in PPTA in that regard. Furthermore, the company has the right to defer the utilization of any loss relief available to it. This is possible where within five months after the end of the accounting period, the company elects in writing not to deduct the amount of the loss or part thereof from the profits of the accounting period under consideration. The amount so deferred will be deducted from the following year's accounting profits unless the company makes a similar election in that following year.

9.06 Treatment of Capital Allowance under Petroleum Profit Tax (PPT)

Capital Allowance (CA) is referred to as allowance granted to tax payers that have incurred Qualifying Capital Expenditure (QCE) as provided in PPTA, QCE include among others, the following:

(i) Pipelines and storage tanks.

(ii) Building and structures.

(iii) Plant, machinery, fixtures, fittings, motor vehicles etc.

(iv) Tangible drilling expenditure.

With effect from 1st April 1977, the law provides for only Annual Allowance (AA) Capital Allowance (CA) in PPTA while in CITA it provides for AA and Initial Allowance (IA). Annual allowance is granted on a straight line basis over a period of five years subject to book value of 1% on each QCE in the fifth year. At the time of disposal, where the proceeds is less than the book value, the difference constitutes a balancing allowance which is claimable by the tax payer. On the other hand, if the proceeds exceed the book value, the difference constitutes a balancing charge which is to be treated as an income to the tax payer.

Rate for capital allowance

Year 1	-	20%
Year 2	-	20%
Year 3	-	20%
Year 4	-	20%
Year 5	-	19%

Investment Tax Credit or Petroleum Investment Allowance

This is an incentive given to any petroleum company for incurring Qualifying Capital Expenditure (QCE). The allowance is computed based on the operational area for which the QCE is located which will be either on shore or offshore. The following apply.

On-shore attracts – 5%

Off-shore vary from

- Up to including 100m of water depth - 10%
- Between 100-200m of water depth - 15%
- Beyond 200m of water depth - 20%

The incentive is referred to as Investment Tax Credit up to 1994 and it forms part of tax offsets. From 1995 the nomenclature is changed to Petroleum Investment Allowance (PIA) and treated like other items of capital allowance and deducted from assessable profit. PIA is granted only once in the accounting period in which the QCE is incurred and put to use.

Illustration

UDOSCO Petroleum Company incurred QCE amounting to N63m out of which N30m is located on shore and the balance distributed as follows:

- Up to 100m depth = N6m

- Between 100m – 200m depth = N4m
- The balance are beyond 200m

Required: Calculate the PIA claimable for the period.

Solution

i.	5% of N30m	1,500,000.00
ii.	10% of N6m	600,000.00
iii.	15% of N4m	600,000.00
iv.	20% of N23m	4,600,000.00
Total PIA		N7,300,000.00

Balancing Allowance and Balancing Charge

Where an asset on which capital allowance has been provided is disposed of the proceed on disposal will be analyzed based on the book value of the asset. If the book value is greater than the proceed, balancing allowance is experienced but if the book value is less than the proceed, we have balancing charge.

Tax Offsets

These are items of expenditure which are allowable up to 1994 year of assessment and are off settable from computed chargeable tax. From 1995 they are not allowable items of expenditure hence deductible to arrive at adjusted profit. These items are:

- Non-productive rent
- Royalties paid on local sales
- Custom duties on essentials
- Investment Tax Credit.

Example

Adebisi Petroleum Co. Plc. is engaged in petroleum operations. The following is a summary of its profit and loss account for the year ended 31st December, 2017:

	N
Sale of crude oil – export	120,000,000
Value of chargeable oil disposed of to local refinery	8,200,000
Sale of natural gas	6,500,000
Incidental income from petroleum operations	1,278,000
Profit from oil refining business (after deducting all related expenses)	7,200,000
Profit from transportation of chargeable oil to other countries (after deducting all related expenses)	3,800,000
Profit on sale of assets	600,000
	147,578,000
Less:	
Production cost	32,000,000
Administrative expenses	8,500,000
Salaries and wages	16,000,000
Expenses on information relating to the existence and extent of petroleum deposits	1,200,000
Customs duties on plant and machinery	1,560,000
Depreciation	3,420,000
Charitable donations	1,000,000
Royalties on crude oil exported	24,000,000
Rent	2,250,000

Court fines	160,000
Interest on loan from subsidiary company	2,500,000
Harbor dues	300,000
First two appraisal wells expenditure	1,450,000
Intangible drilling expenditure	7,400,000
Education tax	768,000
Bank charges and interest	3,350,000
Net profit	41,720,000

Required:

Compute the adjusted profit of the company for the purpose of petroleum profits tax.

Solution

Method 1 Adebisi Petroleum Co. Plc.

Computation of Adjusted Profit for the Accounting Period ended 31st December, 2017

	N	N
Sale of crude oil – export		120,000,000
Value of chargeable oil disposed of		8,200,000
Sale of natural gas		6,500,000
Incidental income		1,278,000
Profit of the accounting period		135,978,000
Less allowable expenses:		

Production cost	32,000,000	
Administrative expenses	8,500,000	
Salaries and wages	16,000,000	
Customs duties on plant and machinery	1,560,000	
Royalties on crude oil exported	24,000,000	
Rent	2,250,000	
Harbor dues	300,000	
First two appraisal wells expenditure	1,450,000	
Intangible drilling expenditure	7,400,000	
Education tax	768,000	
Bank charges and interest	3,350,000	97,578,000
Adjusted profit		38,400,000

Method 2 Adebisi Petroleum Co. Plc.

Computation of Adjusted Profit for the Accounting Period ended 31st December, 2017

	N	N
Net Profit		41,720,000
Less incomes not subject to PPT:		
Profit from oil refining business	7,200,000	
Profit from transportation business	3,800,000	
Profit on sale of assets	600,000	11,600,000
		30,120,000

Add disallowable expenses:		
Expenses on information relating to the existence and extent of petroleum deposits	1,200,000	
Depreciation	3,420,000	
Charitable donations	1,000,000	
Court fines	160,000	
Interest on loan from subsidiary company	2,500,000	8,280,000
Adjusted profit		38,400,000

Notes

(b) Refining of oil and transportation of chargeable oil from Nigeria to other countries are not included in the definition of petroleum operations. The profits from these non-petroleum operations are excluded from the adjusted profit for the purpose of petroleum profits tax. They are taxable under CITA

(c) Profit on sale of assets is excluded from the adjusted profit. It is outside the scope of PPTA. Capital profit or gain is taxable under Capital Gains Tax Act.

(d) Deduction of expenses on information relating to the existence and extent of petroleum deposits is specifically prohibited under s. 13(1)(j) of PPTA 2004.

(e) Deduction of depreciation is specifically prohibited under s. 13(1)(g).

(f) Charitable donations of N1,000,000 are disallowed since they were not wholly, exclusively and necessarily incurred for the purpose of petroleum operations.

(g) Court fines for breach of the law are not allowed.

(h) Deduction of interest on loan from subsidiary company is specifically prohibited under s.13(2) of PPTA 2004.

(i) Education tax is an allowable deduction under s. 10(1)(I) of PPTA.

Artificial or Fictitious Transactions

Transactions between connected persons (e.g. a holding company and its subsidiary company, companies under common control, etc.) may not be made on terms which might fairly have been expected to have been made by independent persons engaged in the same or similar activities dealing with one another at arm's length. If the FIRS feels that such transactions are made to reduce the tax liability of the persons concerned, it may direct that appropriate adjustments be made to counteract the reduction of liability to tax effected or would otherwise be affected.

In order to prevent the avoidance of tax through artificial or fictitious transactions, CITA stipulates that where the FIRS is of the opinion that any disposition is not in fact given effect to or that any transaction which reduces or would reduce the amount of any tax payable is artificial or fictitious, it may disregard any such disposition or direct that such adjustments shall be made as respects liability to tax as it considers appropriate so as to counteract the reduction of liability to tax effected, or reduction which would otherwise be effected, by the transaction and any company concerned shall be assessable accordingly.

"Disposition**"** includes any trust, grant, covenant, agreement or arrangement. A company affected by such direction can appeal against it as if it were an assessment.

9.07. Memorandum of Understanding (MOU)

Rationale and Highlights

There was a fall in the world price of crude oil which resulted in a fall in government revenue in the early 1980s. Oil companies were, therefore, discouraged from making further investment in the Nigerian oil industry. Government had to introduce some fiscal incentives as contained in the (MOUT) signed in 1986 between the Federal Government and oil companies **(joint venture partners)** to enhance crude oil production and exports. The MOU contains the fiscal incentives offered by the government to the oil companies (joint venture partners) to encourage investments in oil exploration and development activities, enhance crude oil exports, oil recovery and gas utilization. The 1986 MOU was revised in 1991. The 1991 MOU has been replaced by the 2000 MOU which took effect from 1st January, 2000.

The MOU is designed to guarantee the oil companies a certain profit margin irrespective of market conditions. The MOU accords a minimum guaranteed notional margin of $2.50/bbl after tax and royalty to the oil company on its equity crude and a minimum of $1.25/bbl after tax and royalty on the NNPC's equity crude which it lifts under the memorandum. The minimum guaranteed notional margin is premised on the fact that the **technical cost (TC) of operation** is not more than the notional technical cost which, at present, is $4.00/bbl. The TC is made up of T1 (Operating Costs) and T2 (Capital Expenditure). The make-up of TC is shown in the Appendix to the MOU.

Where the actual capital investment cost (T2) of the oil company is greater than $2.00/bbl on average, the minimum guaranteed notional margin will be increased to $2.70/bbl for the company's equity crude and $1.35/bbl for NNPC's equity crude lifted.

In relation to joint venture operations between the NNPC and the oil company, the **Government Take** (which is royalty and petroleum profits tax) for any fiscal accounting year is the lower of:

- **Government Take** (i.e. royalty and petroleum profits tax) calculated by substitution of posted price (PP) with official selling price (OSP), and

- **Revised Government Take** (i.e. royalty and petroleum profits tax) calculated by substitution of posted price (PP) with the tax reference price (TRP).

Where the Revised Government Take (RGT) is lower than the Government Take (GT), the amount by which the RGT is less than GT each month will be accumulated and at the end of the fiscal accounting year will be applied as the annual tax credit (MOU credit) to be offset against tax due for that fiscal accounting period.

Calculations

(a) Tax Reference Price (TRP)

This is calculated using the formula:

$$TRP = \frac{RP - (M + O.15 \times FC)}{0.88}$$

Where:

RP = Realizable price

M = $2.50/bbl when actual capital technical costs (T2) is $2.00/bbl or less

= $2.70/bbl when actual capital technical costs (T2) is greater than $2.00/bbl

Example

Qua-Iboe Oil Company Limited produces Bonny Light blend. Given that its realize price (RP), margin (M) and the capital investment cost (T2) per barrel are \$15, \$2.50, \$2 respectively, calculate its tax reference price (TRP).

Solution

Tax reference price (TRP) = $\frac{RP - (M + O.15 \times FC)}{0.88}$

= [15 – (2.50 + 0.15 X 4)]/0.88

= [15 – (2.50 + 0.6)]/0.88

= [15 – 3.1]/0.88

= 11.9/0.88

= \$13.52

(b) Revised Royalty and Revised Petroleum Profits Tax

By substituting posted price (PP) in the PPTA with the tax reference price (TRP) calculated using the above state formula, the revised royalty (Roytrp) and revised royalty (Roytrp) and revised PPT (PPTtrp) are calculated as follows:

Roytrp = RR x TRP x V

Where:

RR = Applicable royalty rate

TRP = Tax reference price

V = Company's crude oil and condensate production

PPTtrp = [(TRP x Vs) – Roytrp – TC] x TR

Where:

TRP = Tax reference price

Vs = Crude oil and condensate sales volume

Roytrp = Revised royalty

TC = Deductions under sections 10, 14 and 18 of PPTA 1990 (i.e allowable deductions, losses & capital allowances excluding royalty)

TR = Applicable tax rate

Example

Qua-Iboe Oil Company Limited produces Bonny Light blend. Given the following information, calculate the revised royalty and the revised petroleum profits tax.

Tax reference price (TRP)	$13.52 per barrel
Production	1,500,000 barrels
Royalty rate	18.5%
Capital allowances	$2,500,000
Allowable deductions excluding royalties	$5,000,000

Solution

Revised royalty (Roytrp) = RR x TRP x V

= 18.5% x $13.52 x 1,500,000 = $3,751,800

Revised PPT (PPTtrp) = [(TRP x Vs) – Roytrp – TC] x TR

= [($13.52 x 1,500,000) - $3,751,800 - $5,000,000 - $2,500,000] x 85%

= [$20,280,000 - $11,251,800] x 85%

= $7,673,970

(c) Revised Government Take (RGT)

This is calculated using the formula:

RGT = Roytrp + PPTtrp + TIP

Where:

Roytrp = Revised royalty

PPTtrp = Revised PPT

TIP = Tax inversion penalty

Example

Ukash Oil Company Limited is in joint venture with NNPC. Given the following information in respect of the company's operations for the year ended 31st December, 2013, calculate the MOU tax credit under the fiscal incentive of the 2000 MOU.

	$
Royalty at RP	95,000
Royalty at TRP	87,000
Petroleum profit tax at RP	140,000
Petroleum profit tax at TRP	128,000
Tax inversion penalty (TIP)	7,500

Note:

RP = Realisable price

TRP = Tax reference price

Solution

Initial Government Take (IGT)= Royalty at RP + PPT at RP

= $95,000 + $140,000

= $235,000

Revised Government Take (RGT) = Royalty at TRP + PPT at TRP+ TIP

= $87,000 + $128,000 + $7,500

= $222,500

(d) MOU Tax Credit

Initial Government Take (IGT)

Less Revised Government Take (RGT)

MOU Tax Credit

(e) Tax Inversion Penalty (TIP)

For the purpose of encouraging unit cost efficiency, a tax inversion penalty (TIP) of 35% is applied as specified in the MOU. To the extent that TI (production operating expenses) is less than $1.70 for any calendar year, the TIP as used in the revised government tax formula is calculated as follows:

TIP = (TR – TIR) x (TI – LTIT) x V

Where:

TR = Applicable tax rate

TIR = Tax inversion rate = 35%

TI = Production operating expenses (as defined in appendix 1 of MOU)

LTIT = Lower tax inversion threshold = $1.70/bbl

V = Company's crude oil and condensate production

So the extent that TI is higher than $2.30/bbl for companies producing above an average of 175,000 bbls/day in the same calendar year, then the TIP shall be calculated as follows:

TIP = (TR – TIR) x (TI – UTIT) x V

Where:

TR = Applicable tax rate

TIR = Tax inversion rate = 35%

TI = Production operating expenses (as defined in appendix 1 of MOU)

UTIT = Upper trigger point for tax inversion for T1 = $2.30/bbl for companies producing above an average of 175,000bbls/day in the same calendar year or $3.00/bbl for companies producing below an average of 175,000bbls/day in the same calendar year.

V = Company's crude oil and condensate production

Example

Given the following information, calculate the tax inversion penalty for Quash Oil Company Limited which is in joint venture with NNPC.

Company's crude oil production	54,750,000 barrels
Average daily production	150,000 barrels
Production operating costs	\$6.50/bbl
Upper Trigger Point for Tax Inversion	\$3.00/bbl

Solution

Tax inversion penalty (TIP) = (TR – TIR) x (TI – UTIT) x V

= (85% - 35%) x (\$6.50 - \$3) x 54,750,000

= 50% x \$3.50 x 54,750,000

= \$95,812,500

MOU is designed to guarantee the oil companies a certain profit margin even if the price of crude oil should fall drastically. Over the years, the price of crude oil has risen to a level that the MOU incentive is no longer tenable. Hence, the MOU between the Federal Government and oil companies (joint venue partners) is in abeyance.

9.08. Assessment of Natural Gas Chargeable Income and Gas Incentives

Incentives for Utilization of Associated Gas

Section 11(1) of PPTA 2004 provides that the following incentives shall apply to a company engaged in the utilization of associated gas:

(a) Invest required to separate crude oil and gas from the reservoir into usable products shall e considered as part of the oil field development;

(b) Capital investment on facilities equipment to deliver associated gas in usable form at utilization or designated custody transfer points shall be treated, for tax purposes, as part of the capital investment for oil development.

(c) Capital allowances, operating expenses and basis of tax assessment shall be subject to the provisions of this Act and the tax incentives under the revised memorandum of understanding.

Section 11(2) of the Act states that the incentives specified under subsection (1) of section 11 shall be subject to the following conditions:

(a) Condensates extracted and re-injected into the crude oil stream shall be treated as oil but those not re-injected shall be treated under existing tax arrangement;

(b) The company shall pay the minimum amount charged by the Minister of Petroleum Resources for any gas flared by the company;

(c) The company shall, where practicable, keep the expenses incurred in the utilization of associated gas separate from those incurred on crude oil operation and only expenses not able to be separated shall be allowable against the crude oil income of the company under the Act;

(d) Expenses identified as incurred exclusively in the utilization of associated gas shall be regarded as gas expenses and be allowable against the gas income and profit to be taxed under the Companies Income Tax Act;

(e) Only companies which invest in natural gas liquid extraction facilities to supply gas in usable form to downstream projects, including aluminum smelter and methanol, Methyl Tertiary Butyl Ether and other associated gas utilization projects shall benefit from the incentives;

(f) All capital investments relating to the gas-to-liquids facilities shall be treated as chargeable capital allowance and recovered against the crude oil income;

(g) Gas transferred from the natural gas liquid facility to the gas-to-liquids facilities shall be at zero per cent tax and zero cent royalty.

All incentives granted in respect of associated gas shall be applicable to investments in non-associated gas (PPTA 2004, s.12). According to ICAN (2006, p. 71):

Associated gas is the gas element of hydrocarbon, which is either utilized or flared in the course of crude oil exploration and production. This can be distinguished from **non-associated gas** as that which exists exclusive of crude oil and is capable of being extracted.

The above provisions of sections 11(1_ and paragraphs (a) – (e) of 11(2) were first inserted in the Petroleum Profits Tax Act by the Finance (Miscellaneous Taxation Provisions) Decree 1998 (i.e. Decree No. 18) with effect from 1st January, 1997. Paragraph (f) and (g) of section 11(2) were inserted in the Petroleum Profits Tax Act with effect from 1st January, 1999 by the Finance (Miscellaneous Taxation Provisions) Decree (No. 30) 1999.

Section 11(2) provides that expenses incurred in the utilization of associated gas should be separated from those incurred on crude oil operation. Associated gas expenses are to be allowable against the gas income or profits to be taxed under the Companies Income Tax Act. Prior to these amendment, gas income taxable under section 9(1)(c) of PPA as part of petroleum profit tax income. Section 11(2) also provides that capital allowance on all capital investments relating to gas-to-liquids facilities shall be deducted from the crude oil income. This implies that capital allowance on capital investments in gas operation cannot be deducted from gas income; it must be deducted from crude oil income.

Example

Odesh Oil Ltd is an oil producing company which is also involved in gas operation. The following information has been extracted from the books of the company:

Oil operation	$
Income	50,000,000
Allowable deductions (including education tax)	20,000,000
Capital allowances	10,000,000
Gas operation	
Income	15,000,000
Allowable deductions	8,000,000
Capital allowances	4,000,000

Required:

Compute the tax liabilities of the company

Solution

(a) Petroleum Profit Tax $

Income		50,000,000
Allowable deductions (including education tax)		20,000,000
Adjusted/assessable profit		30,000,000
Less capital allowances		
Oil operation	10,000,000	
Gas operation	4,000,000	14,000,000
Chargeable profit		16,000,000
Assessable tax (85% of chargeable profit)		13,600,000

(a) Companies Income Tax	$
Income	15,000,000
Allowable deductions	8,000,000
Total profits	7,000,000
CIT (30% x 7,000,000)	2,100,000

Based on the provision of section 11(2)(f), Odesh Oil Ltd can only set off the capital allowances in respect of gas operation ($4 million) against oil income. Assuming that there is no oil income, the company will not be able to deduct the capital allowances of $4 million from gas income.

9.09 Tertiary Education Tax Computation

What is Tertiary Education Tax?

Tertiary Education Tax (formally Education Tax) is a tax imposed on the assessable profits of all companies registered in Nigeria (including companies subject to tax under Petroleum Profits Tax Act) for the enhancement of tertiary education in Nigeria. This tax was imposed by Tertiary Education Trust Fund (Establishment, Etc.) Act No 16, of 2011

The Rate of Tertiary Education Tax

It is charged at the rate of 2 percent (2%) on the assessable profits of a company registered (including petroleum companies) in Nigeria

Those expected to pay Tertiary Education Tax

Every Nigerian company chargeable under the Company Income Tax (CIT) and the Petroleum Profit Tax (PPT) is expected to pay Tertiary Education Tax

Primary objective of the Education Tax

Education tax is intended to achieve restoration, rehabilitation, consolidation and development of tertiary education in Nigeria.

The Due Dates for Filing Returns

Filing of returns for Tertiary Education tax is done along with the Company or Petroleum Income Tax as the case may be.

For companies engaged in petroleum operations, due date for filing is;

1. a) Filing of a return of estimated tax is within 2 months after the commencement of each accounting period, i.e. on or before February.
2. b) Filing of a final return is within 5 months after the end of the accounting period, that is, on or before May.

For companies other than those engaged in petroleum operations due date for filing is;

1. a) In the case of a newly registered company, either within eighteen (18) months from the date of incorporation or six (6) months from the end of the company's first accounting year whichever is earlier.
2. b) In the case of an existing company, within six (6) months from the end of company's accounting year.

9.10 Review Questions

Question I

The following details have been extracted from the books of Ubama Company Limited for the year ended 31st December, 2016.

(i)	Sales of Crude Oil:	
Export		25,000 barrels
Domestic		10,000 barrels
		N
(ii)	Income from supplies	200,000
(i)	Income from interest on current account	220,000
(ii)	Administrative and Operational Expenses	3,000,000
(v)	Royalty on oil exported	3,170,000
(vi)	Customs and other duties	205,000
(vii)	Royalty on local oil sales	370,000
(viii)	Intangible drilling oil sales	50,000
(ix)	The capitalized expenditure written down	
Net of 1% retention for 2012:		
-	2012	3,000,000
-	2013	5,000,000
(x)	Qualifying assets purchased in 2016	9,000,000

The following additional information was provided:

(a) Posted price for crude oil exported was $22 per barrel and exchange rate was N100.00 per $1

(b) Posted price for domestic crude oil was N1,000 per barrel

(c) The capitalized expenditures for 2006 were as follows:

(i)	Onshore	N5,000,000
(ii)	Offshore	N4,000,000

(d) Administrative and operating expenses include:

(i) Donations to Christian Association of Nigeria N50,000

(ii) Depreciation N25,000.

(iii) Donations to social club and political parties amounted to N10,000 and N30,000 respectively.

(e) Included in the figure for export was 2,500 barrels of crude oil sold locally.

You are required to compute:

(i) Fiscal value of chargeable oil

(ii) Total income

(iii) Assessable profit

(iv) Capital Allowance

(v) Chargeable profit

(vi) Assessable tax

(vii) Petroleum Investment Allowance

(viii) Chargeable tax

Solution I

Ubama Petroleum Company Limited

Petroleum Profit Tax Computation for 2016 Year of Assessment

	N	N	N
Value of crude oil exported		49,500,000	
Value of crude oil sold locally		12,500,000	
Fiscal value of chargeable oil			62,000,000
Add: other income:			

Income from supplies	200,000		
Income from interest on current account	220,000		
			420,000
Total income			62,420,000
Less Expenses:			
Royalty on oil exported		3,170,000	
Customs and other duties		205,000	
Royalty on local oil sales		370,000	
Intangible drilling costs		50,000	
Admin and operation expenses 3,000,000			
Less: Donations (50,000+10,000+30,000)		(90,000)	
Depreciation		(25,000)	
		2,885,000	
Education tax		1,092,941	
			(7,773,941)
Assessable profit			54,647,059
Less: Capital Allowance:			
The lower of:			
i. Capital allowance Actual		7,300,000	
Petroleum investment allowance	1,050,000		
	8,350,000		
Or			
ii. 85% of assessable profit		46,425,000	

Less: 170% of petroleum investment		
allowance	1,785,000	
	44,640,000	
Capital Allowance absorbed		(8,350,000)
Chargeable profit		46,297,059
Chargeable tax at 85%		39,322,500
Education tax at 2% of assessable profit		1,092,353

Tutorial Notes

(i) With effect from 1995, investment tax credit was changed to petroleum investment allowance and to be treated like capital allowance.

(ii) With effect from 1996, education tax is to be treated as allowable expense in arriving at adjusted profit of a petroleum company.

(iii) With effect from 1995 year of assessment, royalty on local sale of crude, custom duties on essentials and non-productive rent are to be treated as allowable expenses.

(iv) Donations in whatever form is not allowed for a petroleum company.

Workings

i. Education tax = (62,420,000 - other expenses) x 2/102

= 62,420,000 - 6,680,000) x 2/102 =1,092,941

ii. Value of crude oil exported = (25,000 - 2,500) x (22,100.00)

= N49,500,000.

iii. Value of crude oil sold locally = (10,000 + 2,500) x N1,000

= N12,500,000

iv. Capital allowance computation

2006 Acquisition	9,000,000 x 20%	1,800,000	
2002 Acquisition net of 1% (4 years written off)		3,000,000	
2003 Acquisition net of 1% (3 years written off)			
		(5,000,000/2)	2,500,000
			7,300,000

Petroleum investment allowance

On shore operation (5,000,000 at 5%)	250,000
Off shore beyond 200 meters (4,000,000 at 20%)	800,000
	1,050,000

Question 2

Amaka Petroleum Limited has prepared tax computations for the payment of petroleum profit tax of N12,458,960 for 2017 year of assessment. In arriving at the tax liability, the company had made the following deductions:

	N
Loss brought forward	6,000,000
Unexpensed royalties paid	2,000,000
Custom duty	1,000,000
Capital allowance b/f	15,000,000
Capital allowance for current year	9,000,000
Intangible drilling expenses	8,000,000
Administrative expenses	11,000,000

You are required to compute the adjusted profit, the chargeable profit and the chargeable tax payable.

Solution

Amaka Petroleum Limited

Computation of Petroleum Profit Tax (2017 YOA)

		N	N
Tax payable as computed			12,458,960
Chargeable profit:			
Tax payable grossed up at 85%			
i.e. 12,458,960 x 100/85			14,657,600
Add: disallowable expenses			
Loss brought forward	6,000,000		
Capital allowance b/f	15,000,000		
Capital allowance for the year		9,000,000	30,000,000
			44,657,600
Education tax			757,992
Adjusted profit			43,899,608
Less loss relief			6,000,000
Assessable profit			37,899,608
Less capital allowance:			
The lower of			
Actual capital allowance or		24,000,000	
85% of Ass. Profit		32,214,667	

Less 170% of Pet. Inv. Allow.		
C.A Absorbed		24,000,000
Chargeable Profit		13,899,609
Assessable tax at 85%		11,814,667
Tax Payable		11,814,667

Working:

Education Tax:

Adjusted profit	44,657,600
Less loss	6,000,000
	38,657,600
38,657,000 x 2/102	757,992

MODULE 10

10.00 STAMP DUTIES

10.01 Learning outcome

At the end of this Module, Students should be able to:

i. Demystify the meaning and concept of Stamp Duties and its modus operandi especially within the context of Nigeria;
ii. Clearly examine the underlying conditions for granting waiver for Stamp Duty payment and its associated exemptions;
iii. Identify the various types of instruments and the procedures for their assessment on flat rate.

10.02 Administration of Stamp Duty in Nigeria

Stamp duties are taxes imposed on documents. It is currently governed by the provisions of the Stamp Duties Act of 1939 as amended to date. The tax is relatively cheap to administer and collect.

Since Stamp duty is a tax on instruments. Instrument is defined here as any written document. If a transaction is orally effected or it arises solely from the conduct of the parties, no duty will be due because no document is available to be stamped.

Form of Stamp Duties

There are basically two forms of stamp duties:

(a) Fixed duties

(b) Ad-valorem Duties

(a) **Fixed Duties:** These are duties that do not vary with the consideration for thedocument being stamped. This means that irrespective of the value of the instrument, the same duty is payable. Examples of instruments assessable by fixed duties include:

* Payment Receipt
* Bank Notes or Bills payable at sight
* Cheque Leaves
* Admissions as solicitor or Notary public
* Guarantor forms
* Proxy Forms

(b) **Ad-valorem Duties:** These are duties that vary with the amount of consideration and in accordance with a scale stated in the reliant schedule fixed by the government.

Examples of instruments for ad-valorem assessment include:

* Bills of Exchange
* Share Capitals of Companies
* Mortgage and Debenture Loans
* Promissory Notes
* Property Valuation
* Policy of life Insurance

Schedule of Instruments Subject to Stamp Duties

(a) Agreements

(b) Appraisements

(c) Instruments of apprenticeship

(d) Bank Notes, Bills of Exchange and promissory Notes

(e) Bills of Lading

(f) Contract Notes

(g) Conveyance on Sale

(h) Other Conveyances

(i) Duplicates and Counterparts.

(j) Exchange, Partition or Division

(k) Leases

(l) Letters of Power of Attorney and voting papers

(m) Marketable Securities

(n) Mortgages

(o) Notarial Acts

(p) Policies of Insurance

(q) Receipts

(r) Settlements

(s) Share Warrants

(t) Warrants of Goods

(u) Capital of Companies.

10.03 Stamping of Documents:

It is critical to determine the time a document should stamped, the method of stamping and the significance of denoting stamp.

(a) Time to Stamp Documents

Stamp duties on a document should be paid as it is being prepared before its execution. Where instruments are stamped after execution, a penalty will be imposed. In practice, 40 days of grace is usually allowed for the stamp duties to be paid after execution, in which case the penalty may be waived.

(b) Method of stamping

Essentially, the stamping of a document can be by any of the following ways:

* Embossing with dies
* Printing on the instruments
* Affixing p'0stage stamp in lieu of adhesive stamp
* Affixing adhesive stamp

The following should however be noted concerning stamping of documents:

i. Instruments must be presented at one of the Stamp Duties offices either at the Federal or State level.

ii. The instruments are then impressed with die stamps equivalent to the amount of duty paid. Postage stamps are no longer used.

iii. All the facts and circumstances affecting the liability of any instrument to duty or the amount of the duty chargeable on the instruments should be fully stated on the instrument.

(c) Denoting Stamp

Where an instrument which is being transferred has been duly stamped, the instrument of transfer does not need to be duly stamped again. Under such a circumstance, the instrument of transfer will merely carry a stamp denoting the amount of duty already paid.

Instruments not properly stamped

An instrument is considered to be improperly stamped where it does not carry the correct duty. An instrument which is not properly stamped is still effective because the failure to stamp a document is not an offence in itself. The staff cannot sue for duty on an unstamped instrument. An improperly stamped document is inadmissible in a Court of Law.

Implications of an Improperly Stamped Document

The following are the implications of non-stamping of instrument required to be stamped:

(a) Such an instrument which is not duly stamped in accordance with the law in force at the time it was first executed shall not be given in evidence. This disadvantage cannot be remedied or cured by an agreement between the parties in a case.

(b) Such an instrument is not admissible whether directly or for collateral purpose. The secondary evidence of the instrument is not admissible either.

(c) Cross examination upon an unstamped document is not allowed.

Exceptions to the Admissibility Rule

The stamped or improperly stamped instrument may however be admitted under the following conditions.

(a) Where a criminal proceeding is being held. This is also applicable to a rent tribunal or a proceeding before the Commissioner of Stamp Duties.

(b) Where it is imperative to refresh the money of a witness;

(c) Where it may be used to prove fraud;

(d) Where it is necessary to prove an act of bankruptcy

(e) Where a plaintiff is trying to prevent a transaction from being implementing if it is believed that he agreement is void;

(f) Where the instrument may be admitted subject to an undertaking that the instrument would be stamped later.

10.04 Penalties for Late Stamping

(a) The failure to stamp an instrument is not a criminal offence;

(b) The general rule is that the person presenting an instrument for stamping after the date of executive must pay, not only the unpaid duty but a penalty of N20must be added. II the unpaid duty exceed N20, a further penalty or interest at 10%perannum from the day the instrument was first executed until the interest is exactly equal to the duty payable may also be imposed. This means that the interest payable is limited to the unpaid duty;

(c) In respect of ad-valorem duty, in addition to the unpaid duty, the person must pay a penalty of N20 and a sum equal to the unpaid duty unless there is a reasonable excuse for the delay;

(d) Any penalty due may be remitted by the Commission:

(e) Instruments presented for stamping within 40 days following execution may not have a penalty imposed on it.

The following table summarizes liability to penalty under the Stamp Duties Act.

Title of Instruments	Person Liable to penalty
Bond, Covenant or instrument of any kind security	The obliggee, Convenantee or person taking the
Conveyance on Sales	the vendee or transferee
Conveyance or Transfers operating as	
Voluntary disposition inter vivos	the grantor or transferor
Lease	**Leasee**
Settlement	The Settlor
Mortgage bonds, debenture Convenante .etc.	The Mortgagee or Oblige.

10.05 Review Questions

1. What are the forms of Stamp duty?
2. What do you understand by adjudication?
3. What is the importance of adjudication?
4. Under what conditions may an unstamped instrument be admitted in evidence?
5. What are the implications of improperly stamped document?

MODULE 11

11.00 INTERNATIONAL TAXATION

11.01 Learning outcome

At the end of this Module, Students should be able to:

i. Examine the principles of double taxation arrangement in Nigeria;
ii. Appraise the fundamentals of Treaty Agreements in Nigeria;
iii. Evaluate the mechanics of Transfer Pricing in Nigeria.

11.02 Introduction

The current wave of globalization and technological revolution has had a tremendous effect on international taxation. The financial and economic liberalisation has brought such sophistication and complexity into business practices for Nigerian tax administration with a view into emerging tax problems technology, particularly communication technology. This development has further complicated this problem by making the taxpayer especially the big, non-resident corporations, harder to reach. The system watches helplessly to see that traditional rules are no longer applicable as solutions to international tax problems, thus creating uncertainties which are not satisfactory for business and tax administration. Furthermore, techniques for tax abuses have become too sophisticated for developing economies. Since the business world is always a step ahead, there is a growing need to update knowledge through continuous review of the law and practice of taxation. There are some of the challenges, international taxation seek to address.

Generally, countries of the world interact with each other and engage in activities across their borders for social, economic, cultural, religious, political or any other reasons because no country can live in isolation of others. Cross border transactions can be linked to economic activities between countries, which can be placed under the following classifications;

(i) Trading;

(ii) Carrying on business - exploration, manufacturing, etc.

(iii) Investments or Services;

(iv) Employment; ;

(v) Intangibles/Intellectual Property;

(vi) Sports; and

(vii) Government business.

It is quite interesting to note that these transactions or activities have their tax implications in the source state (i.e. where the income is derived) as well as the state of residence (i.e. where the parties to the transaction reside). Hence, there is a need for proper understating of the guiding principles of international taxation.

11.02.2 Concept of International Tax

It is an a agreement between two countries for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains. The Agreement normally applies to persons who are residents of one or both of the Contracting States. The Agreement applies to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied. It is also regarded as taxes on income, capital, wages or salaries paid by enterprises, as well as taxes on capital appreciation. The existing tax to which the Agreement applies include; the Personal Income Tax, Companies Income Tax, Petroleum Profit Tax, Capital Gains Tax, Education Tax and Other taxes of Income and Capital imposed after the date of signature of the Agreement in addition to, or in place of, the existing taxes.

There is really no tax statute known as International tax law hence the use of the term 'international taxation' may not seem to have much significance. However, for convenience, it is understood among international taxation experts, that the term "international taxation" refers to the relevant aspects/provisions of the domestic tax laws of a country and Double Taxation Agreements (DTAs) which are applicable to taxation of cross-border or international activities.

A taxpayer may be liable to Nigerian taxation, either because he is resident in Nigeria or because the source of his income is located there. A Nigerian resident is liable to tax on his worldwide income, whereas a non-resident will only be liable to tax on Nigerian source income. The concept of Residency becomes evident for clearer understanding of who is liable to tax, where and how for effective tax administration.

Basically, international taxation is divided into two branches. They are;

1. Principles of International Tax - Concept/Conventions
2. Application of International Tax - Treaty Negotiations

Why International Tax Division

In Nigeria tax system; there are two classes of tax payers. They are; resident (individuals & corporate bodies), and non-resident (individuals & corporate bodies). The international tax division deals with the imposition of levies on income earned by non-resident individuals and non-resident corporate bodies involved in cross boarder operations or transactions.

There is growing competitiveness among governments of developed nations and developing nations to attract resources to them to meet the ever growing needs for development. Government introduced incentives such as; tax holidays, low tax rates, accelerated capital allowance, investment tax credits, joint ventures, production sharing contract to attract foreign investors. The division function by way of:

1. Servicing the Nigerian Tax Treaty Secretariats.
2. Implementation of Nigerian Concluded Tax Treaties.
3. Implementation of Nigerian Domestic Tax Laws for non-residents who derived (non-petroleum) income from Nigeria.
4. Liaise with Ministry of Justice, Foreign Affairs, all the Embassies, the National Office for Technology Acquisition and Promotion and Corporate Affairs Commission.

11.02.3 Introduction to OECD Model

Model Tax Convention on Income and on Capital (Organisation for Economic Co-Operation and Development)

The OECD is a unique forum where the governments of 30 democracies work together to address the economic, social and environmental challenges of globalization. OECD is also at the forefront of efforts to understand and to help governments for new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organization is a setting where governments can compare policy experiences, seek answers to problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States. The Commission of the European Unities takes part in the work of the OECD.

It has long been recognized among the member countries of the Organization for Economic Co-operation and Development that it is desirable to clarify, standardize, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial, or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation.

This is the main purpose of the OECD Model Tax Convention on Income and on Capital which provides a means of setting on a uniform basis for the most common problems that arise in the field of international juridical double taxation as recommended by the council of the OECD, Member countries, when concluding or revising bilateral conventions. Member countries should conform to this Model Convention as interpreted by the Commentaries thereon and having regard to the reservations contained therein and their tax authorities should follow these Commentaries, as modified from time to time and subject to their observations thereon, when applying and interpreting the provisions of their bilateral tax conventions that are based on the Model Conventions.

Historical Background

Progress had already been made towards elimination of double taxation through bilateral conventions or unilateral measures when the Council of the Organization for European Economic Co-operation (OEEC) adopted its first recommendation concerning double taxation on 25th February 1995. At that time, 70 bilateral general conventions had been signed between countries that are now Members of the OECD. This was to a large extent due to the work commenced in 1921 by the League of Nations. This work led to the drawing up in 1928 of the first model bilateral convention and, finally, to the Model Conventions of Mexico (1943) and London (1946), the principles of which were followed with certain variants in many of the bilateral conventions concluded or reviewed during the following decade. Moreover, in respect of several essential questions, they presented there were considerable dissimilarities and certain gaps.

The increasing economic interdependence and co-operation of the Member countries of the OEEC in the post-war period showed increasingly and clearly the importance of measures for preventing international double taxation. The need was recognized for extending the network of bilateral tax conventions to all Member countries of the OEEC, and subsequently of the OECD, several of which had so far concluded only very few conventions and some none at all. At the same time, harmonization of these conventions in accordance with uniform principles, definitions, rules and methods, and agreement on a common interpretation, become increasingly desirable.

It was against this new background that the Fiscal Committee set to work in 1955 to establish a draft convention that would effectively resolve the double taxation problems existing between OECD Member countries and that would be acceptable to all Member countries. From 1958-1961 the fiscal committee prepared four interim reports, before submitting in 1963 its final Report entitled "Draft Double Taxation Convention on Income and Capital". The Council of the OECD adopted, on 30 July 1963, a Recommendation concerning the avoidance of double taxation and called upon the Governments of Member countries, when concluding or revising bilateral conventions between them, to conform to that Draft Convention.

The Fiscal Committee of the OECD had envisaged, when presenting its Report in 1963, that the Draft Convention might be revised at a later stage following further study. Such a revision was also needed to take account of the experience gained by Member countries in the negotiation and practical application of bilateral conventions, of changes in the tax systems of member countries, of the increase in International level. For all these reasons, the Fiscal Committee and, after 1971, its successor the Committee on Fiscal Affairs, undertook the revision of the 1963 Draft Convention and of the commentaries thereon. This resulted in the publication in 1977 of a new Model Convention and Commentaries.

The factors that had led to the revision of the 1963 Draft Convention continued to exert their influence and in many ways the pressure to update and adapt the Model Convention to changing economic conditions progressively increased. New technologies were developed and at the same time there were fundamental changes taking place in ways in which cross-boarders transactions were undertaken. Methods of tax avoidance and evasion became more sophisticated. The globalization and liberalization of OECD economics also accelerated rapidly in the 1980s. consequently, in the course of its regular work programme, The Committee on Fiscal Affairs and, in particular, its Working Party, continued after 1977 to examine various issues directly or indirectly related to the 1977 Model Convention. This work resulted in a number of reports, some of which recommended amendments to the Model Convention and its Commentaries.

In 1991, recognizing that the revision of the Model Convention and the Commentaries had become an on-going process, the Committee on Fiscal Affairs adopted the concept of an ambulatory Model Convention providing periodic and more timely updates and amendments without waiting for a complete revision. It was therefore decided to publish a revised updated version of the Model Convention which would take into account the work done since 1977 by integrating many of the recommendations made in the above-mentioned reports.

Because the influence of the Model Convention had extended far beyond the OECD Member countries, the Committee also decided that the revision process should be opened up to benefit from the input of non-member countries, other international organizations and other interested parties. It was felt that such outside contributions would assist the Committee on Fiscal Affairs in its continuing task of updating the Model Convention to conform to the evolution of international tax rules and principles.

This led to the publication in 1992 of the Model Convention in a loose-leaf format. Unlike the 1963 Draft Convention and the 1977 Model Convention, the revised Model was not the culmination of a comprehensive revision, but rather the first step of an on-going revision process intended to produce periodic updates and thereby ensure that the Model Convention countries to reflect accurately the views of Member countries at any point in time.

Through one of the updates, produced in 1997, the positions of a number of non-Member countries on the Model Convention were added in a second volume in recognition of the growing influence of the Model Convention outside the OECD countries. At the same time, reports of a number of previous reports of the Committee which had resulted in changes to the Model Convention were also added.

10.03. Subjects for Treaty Agreements

CHAPTER	ARTICLE	TITLE
Cap. I (One)		Scope of Agreement
	1	Persons Covered
	2	Taxes Covered
Cap. II (Two)		Definitions
	3	General Definitions
	4	Fiscal Residence
	5	Permanent Establishment

Cap.III (Three)		Taxation of Income
	6	Income from Immovable Property
	7	Business Profit
	8	Shipping and Air Transport
	9	Associated Enterprises
	10	Dividends
	11	Interest
	12	Royalties
	13	Capital Gains
	14	Independent Personal Services
	15	Dependent Personal Services
	16	Director's Fees
	17	Artistes and Athletes
	18	Pensions and Annuities
	19	Government Service
	20	Students and Trainees
	21	Teachers and Researchers
	22	Elimination of Double Taxation
Cap. IV (Four)		Taxation of Capital
	23	Non-discrimination
Cap. V (Five)		Method of Elimination of Double Taxation
	24	Mutual Agreement Procedure
Cap. VI (Six)		Special Provisions

	25 26 27 28 29	Exchange of Information Diplomatic and Consular Officials Entry into Force Termination
Cap. VII (Seven)	30 31	Final Provisions

Components of Double Taxation Agreement (DTAs)

CHAPTER I:

Scope of the Convention

Article 1: Persons Covered

This Convention shall apply to persons who are resident of one or both of the Contracting States.

Article 2: Taxes Covered

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are in particular:

a. (In State A):……………………………………………………………………………

b. (In State B):……………………………………………………………………………

4. The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws.

CHAPTER II

Definitions

Article 3: General Definitions

1. For the purpose of this Convention, unless the context otherwise requires:

    a. The term "person" includes an individual, a company and any other body of persons;

    b. The term "company" means anybody corporate or any entity that is treated as a body corporate for tax purposes;

    c. The term "enterprise" applies to the carrying on of any business;

    d. The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State an enterprise carried on by a resident of the other Contracting State.

    e. The term "international traffic" means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;

    f. The term "competent authority" means:

        i. (In State A):………………………………………………………………

        ii. (In State B):………………………………………………………………

    g. The term "national", in relation to a Contracting State means;

i. Any individual possessing the nationality or citizenship or association of that Contracting State; and

ii. Any legal person, partnership or association deriving its status as such from the laws in force in that Contracting State;

h. The term “business” includes the performance of professional services and of other activities of an independent character.

2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purpose of the taxes to which the convention shall be applied.

Article 4: Resident

1. For the purpose of this Convention, the term “resident of a Contracting State” means any person who, under the laws of the State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State of capital situated therein.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

   a. He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

   b. If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State he shall be deemed to be a resident only of the State in which he has an habitual abode;

   c. If he has an habitual abode in both States or in neither of them he shall be deemed to be a resident only of the State of which he is a national;

   d. If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

Article 5: Permanent Establishment

1. For the purposes of this Convention, the term “Permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term “Permanent establishment” includes especially:

A place of Management, a Branch, an Office, a factory, Workshop and A mine, and oil or gas well, a quarry or any other place of extraction of natural resources.

3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

4. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include;

a. The use of facilities solely for the purpose of storage display or delivery of goods or merchandise belonging to the enterprise;

b. The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c. The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d. The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e. The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

f. The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person-other than an agent of an independent status to whom paragraph 6 applies-is acting on behalf of an enterprise and has and habitually exercises, in a Contrasting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, of exercised through a fixed place of business,

would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The first that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident or the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

CHAPTER III

Taxation of Income

Article 6: Income from Immovable Property

1. Income derived by a resident of a Contracting State from immoveable property (including income from agriculture or forestry) suited in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.

Article 7: Business Profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that state unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits to the enterprise may be tax in the other state but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In determining profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

4. Insofar as if has been customary in a Constricting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary, the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

5. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

6. For the purpose of the proceeding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

7. Where profits include items of income which are dealt with separately in other Articles of this Convention. Then the provisions of those Articles shall not be affected by the provisions of this Article.

Article 8: Shipping, Inland Waterways Transport and Air Transport

1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated is situated.

3. If the place of effective management of a shipping enterprise or of an inland waterways transport is aboard a ship or boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship or boat is situated, or, if there is no such home harbour, in the Contracting State of which the operator of the ship or boat is a resident.

4. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

Article 9: Associated Enterprise

1. Where

a. An enterprise of a Contracting State participates directly or indirectly in the management, control or capital or an enterprise of the other Contracting State, or

b. The same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued, to one of the enterprise but, by reason of does conditions have not so accrued may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State and taxes accordingly-profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the among of the tax charged therein on those profits. In determining such adjustment,

due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

Article 10: Dividends

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is resident of the other Contracting State, the tax so charged shall not exceed:

a. 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 15 per cent of the capital of the company paying the dividends.

b. 15 per cent of the gross amount of the dividends if all other cases. The component authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term “dividends” as used in this Article means income from shares, “jouissance” rights, mining shares, founders’ shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, the other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other state or insofar as the holding in respect of which the dividends are paid is

effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 11: Interest

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws or that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "interest" as used in this Article means income form debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bond's or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

4. The provisions of paragraph 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest in respect of which the interest is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebt ness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such

relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12: Royalties

1. Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.
2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.
3. The provision of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.
4. Where, by reason of a special relationship between the payer are the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excuses part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 13: Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other state.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.

3. Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

4. Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.

5. Gains from the alienation of any property, other than that referred to the paragraphs 1,2, 3 and 4 shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14: Independent Personal Services (Deleted)

Article 15: Dependent Personal Services

1. Subject to the provisions of Articles 16,18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived there from may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

a. The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and.

b. The remuneration is paid by, or on behave of an employer who is not a resident of the other State, and

c. The remuneration is not borne by a permanent establishment which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated.

Article 16: Directors' Fees

Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other state.

Article 17: Artistes and Athletes

12. Notwithstanding the provisions of Articles 7 and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.
13. Where income in respect of personal activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income may, notwithstanding the provisions of Articles 7 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised.

Article 18: Pension

Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employ shall be taxable only in that state.

Article 19: Government Service

1. a. Salaries, wages and other similar remuneration paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

b. However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State; or

i. Is a national or that state; or

ii. Did not become a resident of that state solely for the purpose of rendering the services.

2. a. Notwithstanding the provisions of paragraph 1, pensions and other similar remuneration paid, by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or a local authority shall be taxable only in that state.

b. However, such pension and other similar remuneration shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, the State.

3. The provisions of Articles 15, 16,17 and 18 shall apply to salaries, wages, pensions, and other similar remuneration in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

Article 20: Students and Trainees

Payments which a student or business apprentice who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.

Article 21: Teachers and Researchers

A professor or teacher who immediately before visiting Nigeria was a resident of UK is exempted from tax in Nigeria in respect of any remuneration received for teaching or researcher in a university or any other similarly recognize educational institution in Nigeria for a period not exceeding two years from the date of arrival in the country for such purpose. Similarly, the remuneration for a professor or teacher who was resident in Nigeria immediate before his visit to the UK for the purpose of teaching or research is exempted from the UK tax for a period of not more than two years.

This article is applicable to income from research undertaken in the public interest and not primarily for the benefit of some other private public(s).

Article 22: Elimination of Double Taxation

1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Article of this Convention shall be taxable only in that state.
2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

CHAPTER IV

Taxation of Capital

Article 23: Non-Discrimination

1. Capital represented by immovable property referred to in Article 6, owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other state.
2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State may be taxed in that State.
3. Capital represented by ships and aircraft operated in international traffic and by boats engaged in inland waterways transport, and by movable property pertaining to the operation of such ships, aircraft and boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.
4. All other elements of capital of a resident of a Contracting State shall be taxable only in that State.

CHAPTER V

Methods for Elimination for Double Taxation

Article 24: Mutual Agreement Procedure

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

2. Where resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10 and 11, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

3. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

4. The provision of paragraph 1 shall not apply to income derived or capital owned by a resident of a contracting State where the other Contracting State applies the provisions of paragraph 2 of Article 10 or 11 to such income.

Article 25: Exchange of Information

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:

a. As a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;

b. As a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given which is attributable as the case may be, to the income or the capital which may be taxed in that other State.

2. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State I exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

CHAPTER VI

Special Provisions

Article 26: Diplomatic Agents and Consular Officials

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

2. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which national of the State connected in the same circumstances, in particular with respect to residence, are or may be subjected.

3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, relief and reductions for taxation purpose on account of civil status or family responsibilities which it grants to its own residents.

4. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties, and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under

the same conditions as if they has been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are may be subjected.

6. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.

Article 27: Entry into Force

1. Where a person considers that the actions of one or both of the Contracting States results or will result for him in taxation not in accordance with the provisions of this Conventions, he may, irrespective of the remedies provided by the domestic the Contracting State of which he is a national. The case must be presented within three year from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement and difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicates with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.

Article 28: Termination

1. The competent authorities of the Contracting States shall exchange such information as is foreseeable relevant for carrying out the provisions of the Convention or to the administration or enforcement of the domestic laws concerning taxes or every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation there under is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination or appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

a. To carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b. To supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c. To supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

4. If information is requested by Contracting State in accordance with this Article, the other Contracting State shall use it information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to

the limitations of paragraph 3 but in no case shall such limitations be constructed to permit a Contracting State to decline to supply information solely because it has not domestic interest in such information.

5. In no case shall the provisions of paragraph 3 be constructed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

Article 29: Assistance in the Collection of Taxes

1. The Contracting States shall lend assistance to each other in the collection of revenue claims. This assistance is not restricted by Articles 1 and 2. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article.

2. The term "revenue claim" as used in this Article means an amount owed in respect of taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation there under is not contrary to this Convention or any other instrument to which the Contracting States are parties, as well as interest, administrative penalties and costs of collection or conservancy related to such amounts.

3. When a revenue claim of a Contracting State is enforceable under the laws of that State and is owned by a person, at that time, cannot, under the law of that State, prevent its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purpose of collection by the competent authority of the other Contracting State. That revenue claim shall be collected by that other State in accordance with the provisions of its laws applicable to the enforcement and collection of its own taxes as if the revenue claim were a revenue claim of that other State.

4. When a revenue claim of a Contracting State. That revenue claim shall be collected by that other State in accordance with the provisions of its laws applicable to the enforcement and collection of its own taxes as if the revenue were a revenue claim of that other State.

5. Notwithstanding the provisions of paragraphs 3 and 4, a revenue claim accepted by a Contracting State for purpose of paragraph 3 or 4 shall not, in that State, be subject to the time limits or accorded any priority applicable to a revenue claim under the laws of that State by reason of its nature as such. In addition, a revenue claim accepted by a

Contracting State for the purposes of paragraph 3 or 4 shall not, in that State, have any priority applicable to that revenue claim under the laws of the other Contracting State.

6. Proceedings with respect to the existence, validity or the amount of revenue claim of a Contracting State shall not be brought before the courts or administrative bodies of the other Contracting State.

7. Where, at any time after a request has been made by a Contracting State under paragraph 3 or 4 and before the other Contracting State has collected and remitted the relevant revenue claim to the first-mentioned State, the relevant revenue claim ceases to be.

a. In the case of a request under paragraph 3, revenue claim of the first-mentioned State that is enforceable under the laws of the State and is owed by a person who, at that time, cannot under the laws of the State, prevent its collection, or.

   i. In the case of a request under paragraph 3, revenue claim of the first-mentioned State that is enforceable under the laws of that State and is owed by a person, who at that time, cannot, under the laws of that State, prevent its collection.

   ii. In the case of a request under paragraph 3, a revenue claim of the first-mentioned State in respect of which that State may, under its laws, take measures of conservancy with a view to ensure its collection.

The competent authority of the first-mentioned State shall promptly notify the competent authority of the other State of that fact and, at the option of the other State; the first-mentioned State shall either suspected or withdraw its request.

8. In no case shall the provisions of this Article be constructed so as to impose on a Contracting State the obligation:

a. To carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State.

b. To carry out measures which would be contrary to public policy (ordre public);

c. To provide assistance if the other Contracting State has not pursued all reasonable measures of collecting or conservancy, as the case may be, available under its laws or administrative practice;

d. To provide assistance in those cases where the administrative burden for that State is clearly disproportionate to the benefit to be derived by the other Contracting State.

Article 29: Diplomatic and Consular Officials

Nothing in this Convention shall affect the fiscal privileges of members of diplomatic missions or consular posts under the general rules of international law or under the provisions of special agreements.

1. This Convention may be extended, either in its entirely or with any necessary modifications (to any part of the territory of (State A) or of (State B) which is specifically excluded from the application of the Convention or), to any State or territory for whose international relations (State A) or (State B) is responsible, which imposes taxes substantially similar in character to those to which the Convention applies. Any such extension shall take effect from such date and subject to such modifications and conditions, including conditions as to termination, as may be specified and agreed between the Contracting State in notes to be exchanged through diplomatic channels or in any other manner in accordance with their constitutional procedures.
2. Unless otherwise agreed by both Contracting States, the termination of the Convention by one of them under Article 30 also terminate, in the manner provided from in that Article, the application of the Convention (to any part of the territory of (State A) or of (State B) of) to any State or territory to which it has been extended under this Article.

CHAPTER VII

Final Provisions

Article 30: Entry into Force

1. This Convention shall be ratified and the instruments for ratification shall be exchanged at………….. as soon as possible.
2. The Convention shall enter into force upon the exchange of instruments for ratification and its provisions shall have effect:
    a. (in State A):……………………………
    b. (in Sate B):……………………………..

Article 31: Termination

This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year……………. in such event, the Convention shall cease to have effect:

a. (in State A):………………………………

b. (in State B):………………………………

11.02.4 Concept of Residency

Rule of Residency and other Applicable Rules

A taxpayer may be liable to Nigeria taxation, either because he is resident in Nigerian or because the source of his income is located there. A Nigerian resident is liable to tax on his worldwide income, whereas a non-resident will only be liable for tax on Nigerian sourced income. It is important to note that Nigerian double taxation relief (either treaty or unilateral relief) is available only to Nigeria residents.

Residence of an Individual

- Residence is the basis of taxation in most countries.
- A resident individual is a person who has sufficiently close connections to a country whereby he will be liable to tax in that country based on his worldwide income.
- The Personal Income Tax (PIT) law defines an individual as resident in terms of his physical presence in Nigeria.
- A person, who is in Nigeria for a temporary purpose only, and not with a view to establishing a residence will not be regarded as resident in Nigeria, provided he stays for less than 6 months (i.e. 183 days) in any 12 months period 'commencing in a calendar year and ending either within that same year or the following year'.
- Under the Nigerian domestic tax laws, an individual is regarded as resident throughout an assessment year if he:

1. is domiciled in Nigeria;
2. moves in and out for period in all amounting to 183 days or more within 12 - month; or

3. serves as a diplomat in a country other than Nigeria.

- A Nigerian resident individual is liable to tax on his worldwide income, which may also be liable to tax in another country.
- The laws of each country define who is resident in that country for tax purposes. It follows therefore that the laws of two countries may regard the same person as resident in their respective countries.
- A taxpayer may be liable to Nigerian taxation, either because he is resident in Nigeria or because the source of his income is located there. This implies that, an individual may be deemed resident in more than one country. This creates the problem of "dual residence".

Dual Resident – Individual

Conflict may arise between two Contracting States on who has the taxing right over a tax payer, who maintains dual residence - that is, where a taxpayer appears to be resident of both Contracting States.

The following steps are available to the contending tax authorities to determine the status of the affected tax payer;

1. he shall be deemed to be a resident only of the State in which he has a permanent home available to him;
2. if he has permanent home available to him in the two States, he shall be deemed to be a resident only of the State with which his personal and economic interests, are closer (centre of vital interests);
3. where (a) and (b) above cannot be determined he shall be deemed to be a resident only of the State in which he has habitual abode;
4. if he has habitual home in both States or in neither of them he shall be deemed to be a resident only of the State of which he is a national;
5. If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

The resolution process listed above is usually referred to as *"Tie Breaker Rule".*

Domicile

Under English law, every individual must have a domicile and this is the country where the individual is considered to have his “permanent home”. While a person must have a domicile, he may have more than one. At birth, a person acquires automatically, a domicile of origin, which is generally the domicile of his father and this may be supplanted at the age of 18 years of later by the individual acquiring a domicile of choice. Acquisition of a domicile of choice depends essentially on physical presence in a country, combined with an intention to live there permanently. Where a person loses his domicile of choice, his domicile of origin will revive, unless or until supplanted by another new domicile of choice. Although domicile has no special meaning for the purposes of taxation; Person’s domicile is of significance in relation to remittance, employment income, transfer of assets abroad and capital transfer tax (where applicable).

Residence of Corporations

Section 105 of CIT Act defines a Nigerian company as - "any company incorporated under the Companies and Allied matters Act or any Act or any enactment replaced by that Act". However, based on the UK laws, a company is resident where its real business is carried on, and this is the place of the company's central management and control. In determining where a company's central management and control is exercised, the single most important factor is generally the place where the company's Board of Directors meets and makes decisions. However, if central management and control is not in fact exercised by the Board, but by others e.g. a Sub-Committee of the main Board, or even by a single individual such as the managing director, then the place where they exercise control will be the decisive factor in determining the company's residence.

The place of central management and control is the sole test of a company's residence, so that other factors, such as place of incorporation, the residence of directors or shareholders, the location of shareholders' meetings, are of little significance. Thus, a company may be incorporated in Nigeria, but be resident in Ghana vice-versa.

Dual Residence – Corporation

The problem of dual residence often occurs with respect to corporations. A company may be incorporated in one country but may have its management located elsewhere. Under a treaty situation, the tie breaker provided is the location of the place of effective management, although this may not be satisfactory for all situations. A company may also experience the problem of double taxation where it's Nigerian sourced income/profit is also liable to tax in the country of residence e.g. Nigeria versus USA.

Residence and Ordinary Residence

The tax implications being resident or ordinary resident in Nigeria by a taxpayer are that:

- Tax is chargeable on the "aggregate amount" of his "income from sources inside or outside Nigeria" PITA, S. 3 (1) (unlike the non-resident who suffers tax only on that part of his income which is deemed to be derived from Nigeria).
- Double tax relief and allowances can be claimed in full by him (but the non-resident can only claim personal allowance) –PITA S. 33(2).

Residence and Nationality

The Nigerian tax laws apply to a taxpayer on the basis of residence and not on the basis of nationality. As a taxpayer, you are either a resident or a non-resident, regardless of nationality. If one is a citizen of Nigeria, but not resident in Nigeria, he enjoys the same status as a foreign national who is a non-resident. A company meets the requirements for registration and qualifies to operate in Nigeria; it is regarded as a Nigerian company.

11.03 The Concept of Residence under Tax Treaties

Residence in Tax Treaties

The important of residence in bilateral tax treaties lies in its role as basis of allocating taxing rights between the two contracting tax jurisdictions -the country of residence and country of source in order to avoid double taxation. Where the Agreement confers the exclusive right to tax on the country of residence, the country of source does not tax and double taxation is thereby eliminated. Where the country of source has the full right to tax, the country of residence has the right to tax but grants credit for the tax paid at source to avoid double taxation.

Tie Breaker Rules for Individuals

Where there is an argument over residence, the tie breaker provided under paragraph 2 of Article 4 of the Nigerian Tax Treaty is the determination of which of two countries A and B, has a stronger claim on the individual concerned. The first factor to consider is where he has a permanent home. Other factors may be are where he has centre of vital interests usual above and nationality.

Tie-Breaker of a Corporation

The problem of dual residence often occurs with respect to corporation. A company may be incorporated in one country but may have its management located elsewhere. Paragraph 3 of Article 4 provides a tie breaker which is the location of the place of effective management although this may not be satisfactory for all situations.

Comparison between Corporate Resident and Individual Resident

A feature of this comparison lies in the scope of the income liable to tax of a resident individual and that of a resident corporation. PITA S. 3(1) defines the scope of income chargeable as "the aggregate amount each of which is the income of every taxable person, for each year, from a source inside or outside Nigeria. However, section 13 (1) of CITA defines changeable income of companies as the "total profits of a Nigerian company, wherever they have arisen in Nigeria or have been brought into Nigeria". The implications of both provisions are:

(a) A Nigerian resident/individual is chargeable to tax on the global income, comprising of income from "inside or outside Nigeria". By contrast, the chargeable income of a Nigerian company is limited to the Nigerian source of income including those that have been brought to Nigeria from outside sources. Incomes not brought into Nigeria are therefore chargeable in the hands of a Nigerian resident/individual, but not chargeable in the hands of a Nigerian company until these "have been brought into Nigeria".

(b) A Nigerian company can avoid tax by failing to bring income earned from abroad into Nigeria.

Taxation of Foreign Companies

Foreign Taxpayers and the Nigerian Tax System

The Companies and Allied Matters Act (CAMA), 1990 requires a foreign company to register in Nigeria before it can undertake to carry on business in Nigeria. Such foreign companies could also operate through a subsidiary or Permanent Establishment in Nigeria. The concept of Permanent Establishment (PE) is central to the jurisdiction of a source country to tax the profits from foreign trade carried on by a non-resident company within its jurisdiction. The rule is that there is a threshold beyond which a state of course can only tax the income of a non-resident company from sources located within that State; that threshold is the PE by reference to the income attributable to that PE.

Where a company carries on a trade or business in the other country through a PE located in that other country, such a company is liable to tax on the income attributable to that PE. The underlying principle is that a resident company of one country must have a sufficient presence in another country to be liable to tax in respect of its profits from business operations in the other country. Where no such presence exists, or where the presence is not sufficient, that other country from which the income is being derived will have no authority to tax the income being derived from its jurisdiction. For example, if a UK company carries on business in Nigeria, Nigeria has no authority to tax the profits from that business, unless Nigeria is able to ascertain, first that the company has a PE in Nigeria. If it has, then Nigeria has the authority to tax the profits, but only so much of the profits as may be attributable to the business carried on through the PE. If it does not have a PE, it is not liable to tax in Nigeria, no matter the amount of the profit. This principle facilitates the free flow of trade and commerce as well as permits the movement of capital and persons. The concept also creates certainty in tax planning of a foreign trader or investor who has to operate across several national frontiers. He knows when and where he would be subject to tax.

The term 'PE' does not feature in the Nigerian domestic laws. The 1993 tax reforms however introduced the concept of "fixed base" into both CITA and PITA. Although, the terminologies differ, the new concept of a fixed based is basically the same as the concept of a PE. The areas of similarities and differences are highlighted when considering the tax status of a business entity from a treaty country and his counterpart from a non-treaty country. For the company from a treaty country, the standard to apply is the "PE concept" whereas the "fixed based concept" will apply to a company from non-treaty country.

Trading by a non-resident in the other country may be conducted through:

(i) A branch;

(ii) An agency; of

(iii) Presence in the country.

Definition of Terms

- "Trading in a Country" as Distinct from "Trading with a Country"

A non-resident who “carries on a trade in a country” will be liable to tax on the income from that trade, whereas a non-resident who “carries on a trade with a country” will not be liable to tax on that trade receipts, in order to test or determine established as factors to consider in making the distinction viz.

(a) Place of Conclusion of Sales’ Contract

The trade is exercised or carried on at the place where the contracts are made.

(b) Place of Payment

The place of payment is usually tied to place of contract

(c) Place of Delivery

Place of delivery also satisfies the test of jurisdiction.

These three tests are forms of operation which relate to merchandise and are therefore not exhaustive. The substance is where the operations take place from which the profits arise, that is the jurisdiction that has the right to tax. Section 11(2) of CITA, CAP 60 LFN, 1990 provides a general principle for the jurisdiction of Nigeria over the “profits of a company, other than a Nigerian company, from any trade or business”. The law provides certain conditions under which the profits of a non-resident company would be “deemed” to be Nigerian-source profits. These are:

(i) If it has a fixed based business in Nigeria.

(ii) If it has a dependent agent in Nigeria.

(iii) If it operates a turkey project in Nigeria; and

(iv) If the transactions between associated members are artificial or fictitious.

The conditions also confirm largely with the universal concept of PE, though reflecting the Nigerian peculiarities.

11.03.1 Fixed Base Concept under the Domestic Law

The 1990 CITA does not define what constitutes a fixed base, but it states what structures are to be excluded.

(a) Facilities used solely for the storage or display of goods or merchandise.

(b) Facilities used solely for the collection of information.

For a company, the fixed based has to be a place of business, but does not state that the business has to be carried on through that fixed based. The provision in PITA is different in that the business has to be carried on through the fixed base. The existence of a fixed base is sufficient for a company to be liable to tax, but business must be carried on through that fixed base in the case of an individual taxpayer.

Fixed Base Concept under Tax Treaties

Under tax treaty, fixed base does not automatically become a PE. Four conditions must be satisfied for a fixed base to quality as PE:

- It must be a place of business
- The business of the company must be carried on though the fixed base and
- The fixed base must not be excluded by paragraph 3 of Article 5 of relevant tax treaty for being activity of auxiliary or preparatory nature.
- The tax treaties list examples of a fixed base that would normally qualify as a PE.

These include:

- A place of management, a branch, an office, a factory, a workshop
- A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

Dependent Agent

(i) Domestic Laws

Where the non-resident does not have fixed base of business, the profits may still be deemed a Nigerian profit if he operates through a dependent agent in Nigeria. Section 11(2) (b) of CITA, 1990 provides:

"If it does not have such fixed based in Nigeria but habitually operates a trade or business through a person in Nigeria, authorized to conclude contracts on behalf of some other companies controlled by it or which have controlling interest in it…"

This provision requires that the trade or business of the principle must be operated through the agent to quality him as a PE to the principal. This has implications for non-resident companies with multiple agents in Nigeria and which of them would qualify as a PE. This will depend on two factors:

(a) The agent through whom he operates the business; and

(b) The extent of authority given to that agent.

(ii) Subsidiary Company as a PE

The prevailing business arrangement in Nigeria as prescribed by CAMA is the parent/subsidiary business arrangement. A non-resident company seeking to establish business presence in Nigeria should incorporate a subsidiary. The subsidiary in Nigeria may be under the full ownership of the foreign principal through equality participation, but this alone does not make the subsidiary a dependent agent of the parent. The Nigerian Law sees the subsidiary as a separate legal entity. It is not a branch and therefore cannot automatically become a dependent agent, unless the conditions in Section 11(2) (b) of CITA 1990 hold. In other words, a subsidiary becomes a dependent agent where he concludes business contracts on behalf of the parent company or associated member or regularly makes deliveries on behalf of the parent or head office from merchandise habitually maintained in Nigeria by that parent.

(iii) Dependent Agent and Tax Treaties

In relation to the parent and the subsidiary, even where the law regards them as separate entities, the taxing authority may still infer dependent agency status by examining the pattern of transactions between them to see what authority the subsidiary exercises on behalf of the parent company and whether or not, the subsidiary is acting in the ordinary course of its business in dealings with the parent company. Conclusively therefore, an agent becomes a dependent agent and constitutes a PE in Nigeria for the parent company if:

- If loses the "separate legal status" in the dealings with the parent;
- It is dependent economically on the parent;
- It is seen not to be acting in the ordinary course of business in his dealings with the parent.

The above conditions will also apply to a subsidiary which performs functions, the types that an independent agent in similar circumstance would not undertake; in this case, the subsidiary would not be deemed to be acting in the ordinary course of its business. The control structure may therefore not be the main issue here. The conditions also conform largely with the universal concept of PE, though reflecting the Nigerian peculiarities.

From Nigeria perspective, a non-resident company is subject to tax in Nigeria if it has a Permanent Establishment (PE) in Nigeria. Where a company is registered outside Nigeria but derives income from Nigeria, such income will be liable to tax in Nigeria. The tax authorities usually determine whether such company has a Permanent establishment in Nigeria in order to ascertain the extent to which its income will be liable to tax.

It is important to note that exemption from incorporation does not confer exemption from payment of tax on any company in Nigeria. Though the Nigerian tax laws do not specifically mention PE, however, the criteria stated for creating a tax presence in Nigeria largely accord with that of a PE as defined under the Organization for Economic Cooperation &Development (OECD) Model Tax Convention.

The bases of determining Nigerian sourced profits are further explained as follows;

Dependent Agent: If a non-resident company does not have a fixed base in Nigeria but habitually or regularly operates a trade through a person or entity in Nigeria authorised to conclude contracts on its behalf or on behalf of some companies controlled by it, or which have controlling interest in it, or habitually maintains a stock of goods or merchandise in Nigeria from which deliveries are regularly made by a person on behalf of the company, its profit is deemed taxable to the extent that the profit is attributable to that business or trade or activities carried on through that person.

Turnkey Project: A turnkey project is defined as a “single contract involving survey, deliveries, installation or construction", where a single contract covers the supply of equipment or machinery, and/or the installation and/or commissioning of the supplied equipment, the contract is construed to be a TURNKEY project. If a non-resident company engages in trade or activities which could be construed to mean a turnkey project, the profit from that contract is deemed to be derived from Nigeria.

Taxation of employment income

Employment is different from other types of income in that there is only one tax jurisdiction - tax authority of the country of residence. Where the employee is on temporary visit and other conditions hold, the country of residence takes the full right to tax; Where the employee stays longer that the 183 days threshold, the host country takes full right to tax. However for diplomats and civil servants, the home country takes the full right to tax.

Expatriates resident in Nigeria for tax purposes are liable to tax on their employment income from all sources irrespective of where it is paid.

The gain or profit from an employment shall be deemed to be derived from Nigeria if:

1. The duties of the employment are wholly or partly performed in la, unless the duties are performed on behalf of an employer who is in a country other than Nigeria, and the employee is not in Nigeria for a period or periods amounting to 183 days or more in any twelve month period commencing in a calendar year and ending either within that same year or the following year, and the remuneration of the employee is liable to tax in that other country.

2. The employer is in Nigeria, unless the duties of the employment are wholly performed, and the remuneration paid, in a country other than Nigeria except during a temporary visit to or leave in Nigeria.

Treatment of Foreign Income

Where a Nigeria resident individual or company earns foreign income, such will be included in its chargeable income or profit for the year and subjected to Nigerian tax. Section 3(1) of PITA defines the scope of income chargeable *"The aggregate amounts each of which is the income of every taxable person, for each year, from a source inside or outside Nigeria".* Section 13(1) of CITA defines chargeable income of companies as the *"Total profits of a Nigerian company, wherever they have arisen in Nigeria or have been brought into Nigeria ".*However, income of certain professionals earned abroad, brought into Nigeria and warehoused in foreign currency domiciliary accounts is exempted from tax in Nigeria.

A Nigerian resident individual is chargeable to tax on the global income, comprising of income from "inside or outside Nigeria". By contrast, the chargeable income of a Nigerian company is limited to the Nigerian source income, including those that have been brought to Nigeria from outside sources. This further implies that incomes not brought into Nigeria are therefore chargeable in the hands of a Nigerian resident individual, but not chargeable in the hands of a Nigerian company until these "have been brought into Nigeria".

A Nigerian company can avoid tax by failing to bring income earned from abroad into Nigeria.

However tax is normally only charged in respect of residents although the income of an employee even though paid abroad can be assessed to Nigerian tax if the employee is resident in Nigeria for more than 183 days in any year of assessment.

Relief for Foreign Income Tax

In most cases the amounts that would be received in Nigeria could be taxed twice - first in the country where the income originated and secondly in Nigeria where it is received. The tax burden on such income could be unduly high and it may appear as if the resident individual or Nigerian company receiving the income is being penalized for earning foreign income. To minimize the tax impact on such income it is only reasonable that some relief from Nigerian taxation is given to the tax payers concerned.

Relief is given in certain cases where income is liable both to foreign tax and Nigerian income tax. There are broadly speaking two forms of relief granted:

Relief in respect of Commonwealth Income Tax: This consists of relief in respect of income tax charged under the laws of commonwealth countries or the Republic of Ireland on income which is also liable to Nigerian tax. The relief is given by setting of the tax already paid in the Commonwealth country concerned against the tax due in Nigeria.

The following conditions should be noted:

- is only available to residents;
- is only given where the other country concerned has reciprocal legislation. Relief is limited to half the tax applicable.

This form of relief stems from agreements reached with foreign governments whereby certain classes of income are exempted altogether and foreign tax on other classes of income forms a credit against tax payable in Nigeria.

It is important to note that Nigerian double taxation relief (either treaty or unilateral relief) is available only to Nigerian residents.

Inter-Company Transactions not at Arm's Length

(i) Domestic Laws

The 4th condition specified by CITA for deeming the profit of a non-resident, to be a Nigerian profit would be.

"*Where the trade or business or activities is between the company and another person controlled by it or which has controlling interest in it and conditions imposed which in the opinion of the Board is deemed to be artificial of fictitious".*

The above paragraph covers the situation of internal trading between a Nigerian PE and non-resident company where one controls the other or both are members of a multinational enterprise (MNE) and where such transactions are not at arm's length. The deemed profit in this situation is what is adjusted to reflect arm's length transaction. In international taxation, transfer pricing problem implies re-writing of the accounts for the PE to redress artificial or fictitious pricing, but under CITA, the duty to determine the arm's length profits is put on the Board and cannot be delegated.

(ii) Under Treaties

Under the treaties, the existence of divergence between the transfer prices and the open market price's in the transactions within a MNE calls for the re-writing of the books of the PE to counter the artificial shift of profits from one tax jurisdiction to another.

Enforcement of Foreign Revenue Laws

This topic examines the direct and indirect enforcement of claims by foreign revenue authorities as well as overseas' enforcement of claims by Revenue authorities. We should also be examining administrative cooperation between Revenue authorities and criminal cooperation in the tax field.

General Rule

There is a general rule of non-enforcement of foreign revenue claims, although there also exist, a number of significant exceptions to this rule. The degree of cooperation in enforcing foreign tax claims is already extensive. It is a widely recognized rule of private international law that one State will not assist in the direct enforcement of a foreign revenue claim. This rule prevents one State from suing in a foreign court for taxes owed to it. It also prevents a judgement given by the courts of one State for the payment of taxes from being enforced in the other State. Thus, judgements relating to "a sum payable in respect of taxes or other charges of a like nature" are usually excluded from the decided tax cases of countries. Treaty Agreements also do not cover such tax recoveries.

The principle has also been extended from direct enforcement of foreign revenue claims to attempts at indirect enforcement of such claims. The rule is widely recognized between States of a federation. In Nigeria, the Revenue authority of one State may be seen as being unable to enforce tax liabilities in another State.

Mutual Administrative Assistance in Enforcement of Tax Claims

Against this background of the general principle of non-enforcement of foreign revenue claims, many countries have entered into international arrangements for mutual assistance in the enforcement of tax claims. The primary example of this is the article on exchange of information incorporated in most double taxation agreements.

Under Article 27 of the Nigeria DTA, the two Revenue authorities shall exchange such information as is necessary for the implementation of the agreement in the domestic laws of each country which related to the taxes covered by the Agreement.

One issue which has not been faced by the Nigerian courts is whether information can also be sought for the revenue authorities of a foreign treaty partner, even where there is no tax liability. The tax authority's view is that to see such information solely for the purpose of exchange is contrary to the existing laws and administrative practices of the law. The general principle of non-enforcement of foreign revenue claims still remains goods in so far as states may not seek directly to enforce their tax debts in foreign states. Beyond this proposition, however, in-roads have been made into the principle, both, by the developing jurisprudence of the Courts and by international Conventions. It is therefore becoming more difficult to say categorically that one State will not assist directly or indirectly in the collection of tax revenue on behalf of a foreign State.

11.04 Double Taxation

This involves the process of taxing a particular source of income twice due to dual residency or trance border activities. There are two main types of double taxation; economic and juridical.

(i) Economic Double Taxation

This occurs where two different taxpayers suffer tax in respect of the same income, e.g. when a company and the shareholder are regarded as separate taxpayers with each being required to pay its tax. The company pays tax on the profits and the shareholder pays tax again on the distribution from that profit.

Illustration 1

Yankee Ltd is resident in the UK and supplied goods to its subsidiary, Okoro (Nigeria) Ltd, resident in Nigeria for N2,500,000. The FIRS in Nigeria determined that the arm's length price should be N1,500,000, that is, if Yankee Ltd and Okoro Ltd had transacted with each other as independent entities, Okoro (Nigeria) Ltd would have paid N1,500,000 for the goods. The taxable profit of Okoro (Nigeria) Ltd was increased by N1,000,000 because the company would not have been entitled to deduct this amount if it had transacted on an arm's length basis with Yankee Ltd. Okoro (Nigeria) Ltd paid an extra N300,000 tax in Nigeria where the tax rate is 30%. The assessable profit of Yankee Ltd would have been N1,000,000 less if it had supplied the goods for arm's length price of N1,500,000. There would be economic double taxation if the profit of Okoro (Nigeria) Ltd is adjusted upwards by N1,000,000 without the UK tax authority granting a corresponding downward adjustment to the profit of Yankee Ltd by N1,000,000. That would mean that N1,000,000 which had earlier been taxed in the UK as part of Yankee Ltd's profit is again subject to tax as additional profit of Okoro (Nigeria) Ltd.

(ii) Juridical Double Taxation

International juridical double taxation occurs where two or more countries impose similar taxes on the same tax base. This may happen in a situation of dual residence leading to the two countries exercising rights to tax the taxpayers on worldwide basis in each state, in accordance with the domestic laws of the respective states.

Illustration II

V Limited is resident in Nigeria. During the year ended 31st December, 2013, it earned a profit of N3,000,000 from Ghana which is taxable at the rate of 25% by the Internal Revenue Service, Ghana.

Ghana is the source country (i.e. where the income is derived) and has the first right to tax the income. Nigeria is the country of residence of the company and has the second right to tax the income. 25% of the profit, that is, N750,000 is payable as tax in Ghana. When the income is declared to the Nigerian government, it is again subject to tax at 30%, that is, N900,000 is payable to the Nigerian tax authority. The profit of N3,000,000 has suffered double taxation in Ghana and Nigeria. After paying N1,650,000 as tax to the two countries, only a balance of N1,350,000 is left for the company.

It can also arise where a taxpayer has dual residence, that is, the taxpayer is deemed to be resident in two countries under the domestic tax laws of both countries. So both countries will impose tax on the taxpayer as their resident.

Sisi Limited is a company registered/incorporated in Nigeria but is effectively managed in the United Kingdom. Under the Nigerian Companies Income Tax Act, the company is resident in Nigeria because it is registered in Nigeria. Furthermore, under the UK's tax legislation, the company is considered to be resident in the UK because that is the seat of central management and control of the company. The company has dual residence. Assuming that the company's profit in 2013 was N15,000,000 and the Nigerian and the UK tax rates were 30% and 28% respectively, Nigeria would exercise her right to tax the global income of the company, thus, 30% of N10,000,000 = companies income tax of N4,500,000. Similarly, the UK would also exercise her right to tax the worldwide income of the company, that is, 35% of N15,000,000 = corporation tax of N3,200,000. The same profit of N15,000,000 has suffered double taxation in Nigeria and the UK. After paying N4.5 million and N3.2 million as tax, only a balance of N7.3 million is left for the company.

The purposes of treaty negotiation are:

(i) Avoidance of Double Taxation

This refers to the avoidance of double taxation with respect to taxes on income and capital gains. All countries are inclined to cooperate in the elimination of double taxation because of its harmful effects on trade, commerce and movement of persons.

(ii) Certainty of Tax Treatment

Tax treaty allows for predictability which creates certainty. A prospective investor relies on the provisions of the tax treaty for his investment decisions because of the assurance that the treaty is more durable than the domestic law, which is subject to frequent changes.

(iii) Lowering of Tax rates for some Income

This is part of the benefits of tax treaties; The Nigerian tax treaty rate of 7.5% instead of the domestic tax rate of 10%. The Nigerian tax treaties also grant zero tax for airlines and shipping operating in international traffic (where reciprocity exists). For the non-treaty countries, 2% minimum tax on income applies.

(iv) Availability of Tax Benefits

To obtain the treaty benefits, the following conditions must hold:

- The taxpayer must be a resident
- The tax must covered by the treaty
- The taxpayer must be subject to tax on the income; and
- The benefit must not be specially excluded by the provisions of the treaty.

(v) Lowering of Compliance Cost

A tax treaty is advance information to an investor on what rules will apply to the taxation of a particular income. Compliance is thereby enhanced, thus lowering the cost of compliance.

(vi) Prevention of Fiscal Evasion and Avoidance

Tax treaties also aim at prevention of tax evasion and avoidance, which describe tax planning practices which have for long been part of schemes to minimize or escape tax liability especially at the international trade level.

(vii) Cooperation in Tax Matter

Cooperation can be obtained through the following arrangements:

- Exchange of information in relation to cross-border financial transactions, tax havens operations, conduct companies, intro-group transactions and tax avoidance. Transmittal of information may be routine, on request and automatic.
- Non-discrimination which emphasizes that residence and not nationality is the basis of taxation. This is to ensure that all taxpayers who are not nationals of the country of residence are not less favourably treated than the nationals for the purpose of taxation.
- Mutual Agreement Procedure (MAP) through which disputes between two competent authorities are resolved. Disputes may arise in the interpretation or application of the agreement.

Methods of Elimination of Double Taxation

Double Taxation can be avoided under the tax treaties in three different ways.

(i) Through the concession of the exclusive right to tax in the country of residence e.g. with the use of the words “shall be taxable only”.

(ii) Through the exercise of the exclusive right to tax a source of income by the source country, and

(iii) Through an arrangement for limited right to tax where there is concurrent liability to tax. This will require a mechanism that would eliminate double taxation where an item of income "may be taxed" at source and "may be taxed" also at residence.

There are two principal methods by which of double taxation could be eliminated. These are:

(a) Exemption Method

(b) Credit Method

Exemption Method

Here, there are two approaches to the treatment of the exemption, which are full exemption and exemption with progression. Under the full exemption, the State of residence does not tax the income which may be taxed at source. In this way, double taxation is avoided by the non-inclusion of the exempted income in the computation of tax payable at residence. Under the method of exemption with progression, the State of residence may also exempt from tax the income which may be taxable at source but will take the exempted income into consideration in the final determination of the rate applicable to the rest of the Income.

Illustration III

ZAD Ltd is resident in Nigeria. In 2013 its taxable profit was N25,000,000. Included in that amount was an equivalent of N10,000,000 profit derived from a permanent establishment in the United Kingdom on which tax equivalent of N3,500,000 was paid.

Under the full exemption method, Nigeria will exempt N10,000,000 from tax since it was taxed in the United Kingdom. Nigerian company income tax will be imposed on N15,000,000 at the rate of 30% = N4,500,000.

Although an amount which may be taxed in the source country is exempted from tax in the country of residence, the latter may still take that exempted income into account when determining the rate of tax that the resident must pay on its remaining (i.e. non-exempt) income. This is referred to as "exemption with progression".

Credit Method

There are also two types of the credit method:

(a) Full credit method, whereby the country of residence computes tax on the total income, but allows the tax paid at source as credit against the tax payable.

(b) Ordinary credit method, whereby the country of residence computes tax on the total income, but allows the tax paid at source as credit against the tax payable.

Illustration IV

Olodo Ltd is resident in Nigeria. In 2014 its taxable profit was N25,000,000. Included in that amount was an equivalent of N10,000,000 profit derived from a permanent establishment in the United Kingdom on which tax equivalent to N3,500,000 was paid. The UK's tax rate is assumed to be 35%.

Under the "full credit" method, Nigeria computes tax on the total profit and allows a credit for the whole amount of income tax paid in the source country against its own tax.

	N
Total profit	25,000,000
Companies income tax (25,000,000 x 30%)	7,500,000
Less relief for tax paid in source country (10,000,000 x 35%)	3,500,000
Tax due to Nigerian government	4,000,000

Under the "ordinary credit" method, Nigeria computes tax on the total profit but restrict credit allowed to the tax computed which is attributable to the income from the source country.

	N
Total profit	25,000,000
Companies income tax (25,000,000 x 30%)	7,500,000
Less maximum relief for tax paid in source country	

(20,000,000 x 30%)	3,000,000
Tax due to Nigerian government	4,500,000

Commonwealth Income Tax Relief

Commonwealth income tax relief is given in a situation that a company which has paid or is liable to pay tax in Nigeria for any year of assessment on any part of its profits has also paid or is liable to pay Commonwealth income tax for that year in respect of the same part of its profits. The relief is used to reduce the tax paid or payable in Nigeria on that part of the company's profits which is liable to tax in Nigeria and in any country within the Commonwealth or in the Republic of Ireland.

Any claim for Commonwealth income tax relief for any year of assessment must be made not later than six years after the end of the year. For example, if a company wishes to claim the relief in respect of profits earned in 2014 which were subjected to tax in 2015 year of assessment, the claim must be made on or before 31st December, 2021. If the claim is admitted, the amount of tax to be relieved will be paid out of the tax paid for that year of claim or set off against the tax which the company is liable to pay for the year of claim.

Commonwealth income tax relief is granted at the rate determined as stated below;

Nigerian Company

(a) If the Commonwealth rate of tax does not exceed one-half of the Nigerian rate of tax, the rate at which relief is to be given shall be the Commonwealth rate of tax.

i.e. if CWR < ½ NR; = CWR

(b) In any other case, the rate at which relief is to be given shall be half the Nigerian rate of tax. i.e. if CWR > ½ NR; = ½ NR

Illustration

Ti Ltd and Ta Ltd are Nigerian companies. Their profits for 2009 year of assessment are as follows:

	Ti Ltd	Ta Ltd
	N	N
Profits from operations in Nigeria	330,000	363,000
Profits from operations in a Commonwealth country (gross)	142,500	156,750
Nigerian tax	141,750	155,925
Commonwealth tax	19,950	31,350

Required: Compute the Commonwealth income tax relief available to the two companies.

Solution

Ti Ltd.

Computation of Commonwealth Income Tax Relief

for 2009 Year of Assessment

Nigerian rate of tax $= \frac{\text{Nigerian tax}}{\text{Total profits}} = \frac{141,750}{472,500} \times \frac{100}{1} = 30\%$

Commonwealth rate of tax $= \frac{\text{Commonwealth tax}}{\text{Commonwealth income}} = \frac{19,950}{142,500} \times \frac{100}{1} = 14\%$

Since the Commonwealth rate of tax does not exceed one-half of the Nigerian rate, the relief will be given at the Commonwealth rate of tax. Therefore, Commonwealth relief = 14% x N142,500 = N19,950.

Ta Ltd.

Computation of Commonwealth Income Tax Relief

For 2009 Yea of Assessment

Nigerian rate of tax = $\frac{\text{Nigerian tax}}{\text{Total profits}} = \frac{155{,}925}{519{,}750} \times \frac{100}{1} = 30\%$

Commonwealth rate of tax = $\frac{\text{Commonwealth tax}}{\text{Commonwealth income}} = \frac{31{,}350}{156{,}750} \times \frac{100}{1} = 20\%$

Since the Commonwealth rate of tax has exceeded one-half of the Nigerian rate, relief will be given at one-half the Nigerian tax rate. Therefore, Commonwealth relief = 1/2 x 30/100 x N156,750 = N23,512.50.

Non-Nigerian Company

(a) If the Commonwealth rate of tax does not exceed the Nigerian rate of tax, the rate at which relief is to be given shall be one-half of the Commonwealth rates of tax.

I.e. if CWR < NR; = ½ CWR

(b) If the Commonwealth rate of tax exceeds the Nigerian rate of tax, the rate at which relief is to be given shall be equal to the amount by which the Nigerian rate of tax exceeds one-half of the Commonwealth rate of tax.

i.e. if CWR > NR; = NR – ½ CWR

Illustration

During the year ended 31st December, 2017, Soso Limited, a non-Nigerian company earned a profit after tax of N1,260,000 from its operations in Nigeria. Assuming that the Nigerian rate and the Commonwealth rate of tax are 30% and 20% respectively calculate the Commonwealth income tax relief available to the company.

Solution

Profit before tax = N1,260,000 x 100/70 = N1,800,000

Since the Commonwealth rate does not exceed the Nigerian rate, relief will be given at the rate of one-half of the Commonwealth rate of tax. Therefore, Commonwealth relief = 1/2 x 20/100 x N1,800,000 = N180,000.

Illustration

Assuming that the facts are the same as in illustration above except that the Commonwealth rate is 36%, calculate the Commonwealth income tax relief available to the company.

Solution

Since the Commonwealth rate exceeds the Nigerian rate, the rate at which relief will be given is:

Nigerian rate	30%
Less one-half of the Commonwealth rate (1/2 x 36%)	18%
Rate of relief	12%
Amount of relief (12/100 x N1,800,000)	N216,000

Tax Havens

This is defined as "a country that imposes little or no tax on the profits from the transactions carried on from that country". This type of arrangement has often led to accusations and counter-accusations which country is operating an unfair tax regime. It is therefore not easy to come into agreement on which country does or does not constitute a tax haven. This fact has therefore led to the re-definition of what constitutes a tax haven. The new distinctions are:

- Whether adjustment to tax rates are aimed at financial capital flows or at real economic investment.
- The level of substantial activities attached to the investment flow; and
- Willingness to exchange information with other tax jurisdictions.

There is therefore not single definition for a tax haven but rather, there are several categories of preferential treatments that will be considered as a tax haven.

- Where no tax is paid at all;
- Where minimal tax is paid; and
- Where certain types of activities are granted privileges.

The common feature is that they serve as conduit for investments or transactions that have their real economic activities elsewhere.

Typically, international transaction between two high-tax rate countries may be routed through a tax haven company, trust, or other entity so that any resulting profits or investment income is realized in the tax haven with consequent minimization of tax payment.

Some of the main types of tax haven operations are:

a. Holding Companies: A taxpayer resident in a non-tax haven country wishing to invest funds will, instead of doing so directly, transfer those funds to a specially formed tax haven company. The investments will then be made by the tax haven company so that the resulting income will be subject to nil or low rates of tax. Similarly, a tax haven company may be interposed between a parent company in a non-tax haven country and its overseas subsidiaries which are only subject to the rates of tax (if any) applying in the tax haven.

b. Captive Insurance Companies: A captive insurance company is one that is formed specifically by a group of companies to insure their own risks (e.g. cost plus a small mark-up) and sells to independent purchasers at the full market price, ensuring that most or all of the profit from the transaction accrues in the tax haven. Similarly, financial or management services between companies in a multinational group may be routed through an affiliated tax haven company, so that payments (which may be tax deductible) accrue in the tax haven.

c. Banking: Virtually, all the major banks have branches in one or more tax havens, and while genuine financial transactions may be carried on in tax havens, such as Hong Kong or Singapore, other tax havens, e.g. Bahamas and the Cayman Islands, are regarded as being no more than “booking centre” where the ledgers and formal records are kept but the actual transactions are carried on elsewhere.

d. Transfer Pricing: Export sales of a company or multinational group may be channelled through a specially formed tax haven sales or distribution company. The tax haven company purchases items from affiliated companies at the lowest possible price.

e. Licensing: Patents, trademarks, copyrights etc. of a non-tax haven company or multinational group may be held by a tax haven company, so that royalties, either from third parties or even from affiliated companies are received in the tax haven and so subject to a nil or low rate of tax.

Estimates of the amount of revenue lost through the use of tax havens are extremely difficult to make by virtue of the secrecy surrounding the subject and the consequent dearth of information. The premiums paid by the companies in the group will be deductible and if the captive insurance company is located in a tax haven, any insurance profits or investment income will be subject to nil or low tax. Bermuda is the principal tax haven for captive insurance companies, although they are also located in the Cayman Islands and Bahamas.

Tax Sparing

This is a provision in tax treaties that seeks to protect the tax incentives which the government grants to companies as part of the economic development strategy. The intention of government is that the benefits would accrue to the targeted investor. Without a tax-sparing provision in a bilateral agreement, such benefit would be captured by tax policy of the investor’s country of residence. The income which the government has spared through its incentive legislations may thereby flow, not to the investor directly, but to the government of the country of the investor’s residence.

Various tax incentive are offered by the government in other to attract foreign investment into Nigeria, for instance, certain income derived from Nigeria by foreign companies are granted tax exemption. If, for example, Samila Ltd which is resident in USA derives a net annual income of N600,000 from Nigeria and she is granted a tax exemption, a company will not pay Nigeria income tax which should have been N180,000 (i.e. 30% x N600,000).

Let us assumed that a rate of tax in USA is 40% and USA grants credit of tax paid in the country from which the income is derived. Since no tax was paid on the income in Nigeria, Samila Ltd will paid N 240,000 (i.e. 40% x N600,000) tax on the income in USA. As you can see, the company has not really enjoyed the incentive granted by the Nigeria government because the income spared from tax in Nigeria has been subjected to tax in the country of resident (USA) without any relief being giving. To avoid such situation, some country have a tax sparing provision in their double taxation agreement.

A tax sparing provision compels a tax jurisdiction to, in addition to credit for tax actually suffered in the jurisdiction of source of the income; grant a normal credit to a taxpayers whose foreign income has been spared from tax in the country of source due to tax incentives existing in the country.

Continuing with the above example, a tax sparing provision in the double taxation agreement between Nigeria and USA would require USA to grant the company credit for the tax which ought to have been paid in Nigeria but which was not paid due to the tax incentive. USA will grant the company a credit of N180,000 (30% x N600,000) so that the company will pay only N60,000 (i.e. N240,000 - N180,000) in USA.

Nigeria has a tax sparing provision in some of its double taxation agreement. Two examples are giving below:

(a) Paragraph 3 of article 33 of the DTA between Nigeria and Pakistan state:

For the purposes of allowance as credit against the tax payable in Nigeria or Pakistan, as the context required, the tax payable in a contracting state shall be deemed to include the tax which is otherwise payable in that state but has been reduced or exempted by the state in pursuance of its tax incentive programme.

(b) Paragraph 3 of article 23 of the DTA between Nigeria and Romania state:

For the purpose of paragraph 2 of this article the tax paid in Nigeria shall be deemed to include any amount which should have been paid or payable as Nigeria tax for any year but for an exception or deduction of tax granted that year or any part thereof.

Treaty Shopping

Treaty shopping arises where a non-resident of either of the treaty countries establish an entity in one of the treaty countries in order to obtain treaty benefit that would not be available directly. This situation can arise where the country in which a person is resident does not have a tax treaty with the country in which his income is derived (source country) the person may have to set up an entity in another country which as a tax treaty with the source country in other to benefit from the provision of the tax treaty.

Treaty shopping is an analysis of tax treaty provision by non-treaty party to structure an international transaction or operation so as to gain or take advantage of a particular treaty benefit. This practice consists in a resident of a state that is not a party to the double taxation treaty establishing an entity within a state that is party to the treaty in order to take advantage of is provision.

Consider a situation that there is a double taxation treaty between country A and country B. Instead of a company resident in country C (which does not have a tax treaty with country A) investing directly in country A, it establishes a legal entity in country B through which it invests in country A in order to take advantage of country A/country B tax treaty to minimize its tax liability. It can be seen from the example that the tax treaty which is intended to benefit the resident of a non-treaty countries in a way unintended by the treaty partners. On the other hand, since there is no tax treaty between countries C and the treaty countries (countries A and B), resident of countries A and B will not receive equal tax treatment with respect to income derived from country C. Thus, the principle of reciprocity is breached.

The problem of treaty shopping can be tackled in different ways. For example, some countries now include in their tax treaties specific provision popularly referred to as “limitation on benefit” or “LOB” provisions that limit the benefit under the treaties in certain circumstances. Companies which are not bona fide residents of the treaty countries or which are set up for treaty shopping purpose may be denied the treaty benefits. Some countries rely on anti-treaty shopping provisions in their domestic laws to tackle the problem.

Tax Treaty Models

The negotiation of bilateral tax treaties is facilitated by models provided by international conventions, e.g.

- Organization for Economic Cooperation and Development (OECD) Model Tax Convention on income and capital.
- United Nations (UN) Model Double Taxation Convention between developed and developing countries.

(i) OECD Model

This is the model for the negotiation of tax treaties between the OECD members who are mainly from the capital exporting, advanced economics of the world. The OECD Model focuses mainly on residence and this makes it difficult for its wholesale acceptability to developing countries.

(ii) UN Model

This is the standard for the negotiation of tax treaties between the developed and developing countries. The main differences between the OECD and UN models are in the areas of:

- Determination of PE (Article 5)
- Attribution of profits to PE (Article 7)

Article 5	Time threshold of 12 months prescribed for PE	Adopts a shorter period of six (6) months
	Activities that constitute PE are limited to building site and construction or installation projects	Activities constitute PE include assembly projects and supervisory activities.
Article 7	Upholds the principle of force of attribution.	Upholds the principle of force of attraction
	Allowance of all expenses attributed to PE	Allows only expenses attributable to reimbursement of actual expenses.

(iii) Nigeria Model

The Nigeria Model takes care of variation of Nigerian peculiar needs from the other two models earlier discussed.

(a) Concept of Force of Attribution

The principle establishment in Article 5 of both Models is that profit which a non-resident company makes from its active income is taxable in the source country only if the company has a PE in that country. Article 7 of the OECD Model goes on to say that the amount of the profit that can be so taxed is limited to the quantum that is “attributable” to the PE, it the profit which it might be expected to make, if it were a distinct and separate enterprise engaged in the same of similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. Where there are several PEs which a company may have in another State, the principal implies the separate attribution of profits to each of the PE’s.

(b) Concept of Force of Attraction

This principle is an anti-avoidance provision to counter the split of profits through the creation of several PEs within a jurisdiction. Under the principles, the profit of these other PEs would be aggregated for tax purpose in as much as the products or activities are the same as, or similar to, those effected through the main PE. Once a non-resident company has a PE in the other State, all the business activities that are “the same or similar” to those carried on through the PE will be deemed to be carried on through the PE. In the other words, the income from these other outlets would be attracted to the PE.

Assistance in Tax Collection

Tax collection rules in Nigeria are only in respect of income derived or deemed to be derived from Nigeria. It does not cover the collection taxes imposed or collectible by another tax jurisdiction. The statutory authority for the conclusion of tax treaties in Nigeria covers only assessments and not collection. However, recent developments have shown that treaty partners are now requesting for the extension of the Mutual Agreement Procedure (MAP) to cover assistance in tax debt recovery. Some of the limitations here are:

- There is need for an authority in the domestic law to confer the right to collect foreign tax.
- Lack of capacity of member countries to initiate action or respond to such requests for assistance.
- Legal institution in the respective countries to recognize the process.
- Other considerations, e.g. reciprocity, cost of litigation, administration burden that are likely to hinder such assistance.

Indiscriminate levy of assessment by SIRB	If the banks are presently doing some level of supporting why asking for more
Pioneer Status for Film Industry. The local industry needs foreign support	The way forward is the goal, not getting loans because of who we know?
Industry has failed to advise their numerous customers.	Commission to serve the interest of all parties; let us learn to trust ourselves.
EIS-Enterprise Investment Scheme Section	Tax administration is gradually changing its

48.	poor image to new orientation

11.05 Transfer Pricing

Transfer Pricing is the process of arriving at a price charged for goods or services supplied or transferred by one subunit of an organization to another subunit or one member of a group to another.

It is also referred to as the price at which an enterprise transfer physical goods and intangible property or provides services to associated enterprises. The term transfer price can also be referred to as the price attached to transactions between divisions, branches or subsidiaries, of a company.With particular reference to multinational companies or enterprises (MNEs), transfer pricing is a mechanism used for measuring the value of goods and services transferred among members within the group.

The practice among MNEs of adjusting prices of goods and services as they move around their global operations is commonly referred to as transfer pricing and described in the Nigerian tax laws(CITA,S.22) as “artificial or fictitious” transaction when not at arm’s length (mispricing). A transfer pricing design may be a scheme to evade or avoid tax. It is very complex, particularly in relation to multinational companies, although the term can also apply to purely domestic transfers.

A transfer price may be determined based on the external market price (or open market price) for a similar product (market-based transfer price) or it may be based on the cost incurred in making the product (cost-based transfer price) or it may be determined through negotiation between the subunits or members of a group buying and selling the product (negotiated transfer price).

The issues of transfer pricing will therefore be of relevance for two reasons:

(i) Adequate adjustment for transfer pricing is a potential source or revenue; and

(ii) Measures to counter transfer pricing is a protection of the revenue base from possible manipulation of the MNEs to shift profit from source country to elsewhere or to gain tax advantage through tax avoidance or fraud.

It also refers to the prices at which the following are transferred between connectable taxable persons:

(a) Tangible goods (raw materials, spare parts, finished goods, etc.);

(b) Services (marketing, legal, accounting, insurance, management services, training, etc.);

(c) Intangibles (trademarks, patents, copyright, etc.).

The definitions address direct and indirect control. The laws have not defined what constitutes control, but Article 9 of the tax treaties is borrowed from OECD to determine control in terms of:-

(i) Direct or indirect participation in capital

(ii) Direct or indirect participation in control, and

(iii) Direct or indirect participation in Management.

Significance of transfer pricing

Transfer Prices at which goods and services are transferred between entities are significant for both taxpayers and tax authorities, because they impact on the income and expenses as well as taxable profits of related companies in different tax jurisdictions in which the enterprises and multinationals operate. Many companies are interested in maximizing their head office profits, hence they may adopt transfer pricing mechanism which boost the head office profits at the detriment of the associated or subsidiary companies which operate in other high tax jurisdictions. In other words, transfer pricing affects the profits on which the affected enterprises are subjected to tax. Since associated enterprises transact businesses among themselves, considerations other than arm's length conditions sometimes dictate the prices at which goods and services are transferred within the group. This could result in the shifting of profit from the tax jurisdictions in which they arise to jurisdictions which are more convenient and beneficial to the head office or the group company.

Let us consider an example of a multinational company which has its subsidiary in Nigeria and head office in Senegal. The Nigerian subsidiary charges low prices (below open market prices) for goods supplied to the parent company in Senegal. On the other hand, the parent company in Senegal overcharges the Nigerian subsidiary for services rendered to the subsidiary.

Consequently, the Nigerian subsidiary records low profits and pays less tax to the Nigerian Government, while the parent company declares more profits and pay more tax to the tax authority in Senegal. As rightly pointed out by Arogundade (2005), what a country loses through the shift of profit is a gain to another country to which the profit is shifted.

Relevance of Transfer Pricing

Transfer pricing has linkage with "Global Stability, Revenue Generation, Economic Growth, Trans Border Activities and International Trade" in the following three ways:

(a) Promotes stable flow of labor, capital, goods and services across national borders of the world.

(b) Secondly, there is the over-arching issue of the right of each country to generate the right amount of tax revenue from the economic activities performed within its boundaries.

(c) Thirdly, transfer pricing would promote economic growth at unilateral, bi-lateral and multilateral levels.

Importance of Transfer Pricing in Taxation

Transfer Pricing (TP) has gained unprecedented popularity among tax jurisdictions for various reasons; among which are:

- Globalization: Advancement in technology (transportation, information and communication) has brought distant parts of the world closer than before. National boundaries are fast disappearing as the flow of labor, capital, goods and services is no longer restrained by geographical factors. In consequence, goods, services and intangibles produced by entities of a group in one country can be transferred to entities of the same base in other countries. The pricing of the resulting transfers presents a fertile ground for transfer mispricing among tax authorities of receipts and payments.
- Specialization: Business entities are increasingly embracing the principle of division of labor, specialization and comparative advantage to set up facilities in parts of the world that offer them maximum yield on one unit of factor of production. This has led to the development of the concept of shared-services whereby certain services (accounting, human resource management, etc.) are centralized and sited in different countries. The

costs of these centers must be re-billed to all the entities sharing the services; tax authorities have concerns as to the fairness of the billings.

- Mergers and Acquisitions: Increasingly, companies are moving into other countries and buying up other companies. Costs of central administration or other transfers from one entity to another in the group must satisfy tax authorities in the respective countries.

In all of the foregoing, the concern of governments is the possibility of revenue being shifted away from their jurisdictions in the face of increasing pressure to meet the aspirations of its citizens by providing adequate social infrastructure and as such incidence of revenue losses would be stoutly contested.

Legal framework for transfer pricing

The institution of a transfer pricing regime took a long time to be in Nigeria. Several statutory provisions gave powers to Nigerian tax authorities to make adjustment on tax returns if transactions between connected persons were not done following the arm's length principle. General Anti-Avoidance Rules (GAAR) have been in the books in Nigeria for many years. Specifically, Section 17 of the Personal Income Tax Act, Section 22 of the Companies Income Tax Act, and Section 15 of the Petroleum Profits Tax Act all provide for FIRS to adjust any transaction between intercompanies or between related parties which is deemed to produce a result artificially reducing taxable income in Nigeria. Other statutory provisions include Section 61 of the Federal Inland Revenue (Establishment) Act 2007; and the Income Tax (Transfer Pricing) Regulation Act of 2012.

In exercise of the powers conferred by section 61 of the Federal Inland Revenue Service (Establishment) Act, No 13 of 2007 ("the Act") and all other powers enabling it in that behalf, the Board of the Federal Inland Revenue Service established under section 3 of the Act ("the Board") with the approval of the Minister enacted the Income Tax (Transfer Pricing Regulation) No.1 of 2012.

Purpose, Objective and Scope of Application of Transfer Pricing Regulations

(a) **Purpose**

The 2012 Regulations give effect to the provisions of:-

(i) section 17 of the Personal Income Tax Act, CAP P8, Laws of the Federation of Nigeria, 2004;

(ii) section 22 of the Companies Income Tax Act, CAP C21, Laws of the Federation of Nigeria, 2004 (as amended by the Companies Income Tax (Amendment) Act 2007; and

(iii) Section 15 of the Petroleum Profits Tax Act, CAP 13, Laws of the Federation of Nigeria, 2004 (as amended by the Petroleum Profits Tax (Amendment) Act, 2007.

(b) **Objectives**

The objectives of the Regulations are to:-

(i) ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activities deployed by taxable persons in Nigeria, including in their transactions and dealings with associated enterprises;

(ii) provide the Nigerian authorities with the tools to fight tax evasion through over or under-pricing of controlled transactions between associated enterprises;

(iii) provide a level playing field between multination enterprises and independent Enterprises doing business within Nigeria; and

(iv) Provide taxable persons with certainty of transfer pricing treatment in Nigeria.

(v) Provide certainty of transfer pricing treatment in Nigeria.

(vi) reduce the risk of economic double taxation

(c) **Scope**

The Regulations shall apply to transactions between connected taxable persons carried on in a manner not consistent with the arm's length principle and include:-

- sale and purchase of goods and services;
- sales, purchase or lease of tangible assets;

- transfer, purchase, licence or use of intangible assets;
- provision of services;
- lending or borrowing of money;
- manufacturing arrangement: and
- Any transaction which may affect profit and loss or any other matter incidental to, connected with, or pertaining to the transactions referred to in the regulation.

For purposes of applying these Regulations, Permanent Establishments ("PEs") are treated as separate entities, and any transaction between a Permanent Establishment ("PE") and its head office or other connected taxable persons shall be considered to be a controlled transaction.

Features of Nigerian Transfer Pricing Regulations

Transfer Pricing Regulation No. 1 of 2012 was signed into law in August 2012 and gazetted in September 2012. Its commencement date was 2 August 2012, but taxpayers are expected to commence filing of transfer pricing returns from 2013 year of assessment. Every taxpayer is therefore expected to develop Transfer pricing policy in regards to transfer pricing and control transaction, as well as treatment of transactions of Permanent Establishment (PE) and dispute resolution.

Transfer pricing and multinational companies

Multinational companies are those which have offices, factories, branches, subsidiaries, business activities and relationship in many different countries. In other words they are large enterprises which have centres of operation in many countries in contrast to an "international" firm which does business in many countries but is based in only one country, though the terms are often used interchangeably. In Nigeria today, oil sector is dominated by multinational companies such as ExxonMobil, Totalfina Elf, Chevron, Texaco, Agip, Shell Petroleum Development Company, etc. Other organisations in Nigeria which include Cadbury, Guinness, PZ, Nestle, Unilever, Procter and Gamble, GlaxoSmithKline, MTN, Airtel, Reckitt Benckiser, etc. Many multinational companies have subsidiaries, sub subsidiaries, associated companies, parent companies, joint ventures, etc. that carry out business activities in many countries of the world. They are therefore subjected to the tax authorities of many different countries.

Most times, activities of multinationals result in the followings:

Different pricing of goods / services; Transfers could be done at Cost by multinational group. One member of the group in one country may supply goods or services to another member in another country. The prices charged create sales revenue for the company selling the goods or services and purchase cost for the company buying the goods or services. These will eventually affect the profits of each company which are accountable to different tax jurisdictions.

Example:

A multinational company has its subsidiary in Nigeria and head office in Malaysia. The Nigerian subsidiary charge low prices (below open market prices) for goods supplied to the parent company in Malaysia. On the other hand, the parent company overcharges the Nigerian subsidiary for services rendered to the subsidiary. Consequently, the Nigerian subsidiary records low profits and pays less tax to the Nigerian Government, while the parent company declares more profits and pays more tax to the tax authority in Malaysia. As rightly pointed out by many authors, what Nigeria loses through the shift of profit is a gain to Malaysia to which the profit is shifted to.

Tax Fraud: Multinational transfer mispricing can provide an avenue for tax fraud. Companies within the same group which are under different tax jurisdictions may decide to overprice or underprice inter-group transactions depending on what they want to achieve. Consider a foreign company which has a factory in Nigeria where many tax incentives are offered. Because of these incentives, the foreign company ends up paying lower income tax in Nigeria. The company is motivated to fix the transfer prices for goods transferred to the parent company in Singapore as high as possible. Consequently, maximum profits are reported in Nigeria where the income tax rate is lower and less income reported in Singapore where the income tax rate is higher.

Custom Duties & Tariff Manipulation: Transfer prices will also affect customs duties paid on imports and exports. For example, if the transfer prices on imports into a country are lowered, the import duties and other tariffs on the imports will equally be reduced. It will be high if transfer prices are high.

Dividend Manipulation: Multinational transfer prices may also be influenced by dividend considerations. Consider a situation that Nigeria puts a restriction on the amount that a company can pay out as dividend to parties outside the country. A parent company based in Germany may decide to overprice goods and services transferred to its subsidiary in Nigeria. In that way, more funds leave the subsidiary company in Nigeria to Germany without appearing to violate the dividend restriction.

Imposition of Excessive charges: Parent company can also impose excessive charges (e.g. royalties) on its foreign subsidiaries, associates, etc. in respect of the provision of intangibles such as patents, licenses, trademarks, etc. and use these avenues to siphon funds to tax heavens or jurisdictions with favourable tax requirement. Where the head office of the multinational or a member of the group incurs expenses which are for the benefits of all or many members of the group, the allocation of the joint costs to members of the group will certainly affect their profits and taxes.

"In a global economy where multinational enterprises (MNEs) play a prominent role, governments need to ensure that taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein. For taxpayers, it is essential to limit the risks of economic double taxation that may result from a dispute between two countries on the determination of the arm's length remuneration for their cross-border transactions with associated enterprises" (OECD, 2012).

From the few instances above, there is every justification for Nigerian Government paying close attention to taxes paid by subsidiaries, branches, associates, etc. of foreign companies operating in Nigeria.

Form of Transfers

The forms of transfers in MNEs may be classified into four categories:

(a) **Transfer of Tangible Goods**

This covers inter-company sales and purchase of goods, such as raw materials, intermediate products, spare parts and finished products. The cost of manufacturing a particular brand of goods may be borne by the parent, a member or a Cost-center and sold within the group. The assigned price for the transfer of the goods between members may be higher than the price of the same or similar goods sold by the MNE to an un-related company.

(b) **Transfer of Services**

The services centrally provided may include marketing, advertisement, corporate finance, legal, consultancy, credit and accounting services, overhead services, banking, trading, management and technical services. The centralization is either in the parent company (head office) itself or in another company formed for that purpose. The costs may be pooled into a base for allocation to member companies.

(c) **Transfer of Research and Development**

The MNEs may conduct Research and Development (R&D) centrally. These are costs contribution arrangements whereby the members have a share in the cost of the R&D, even though the cost may not have any direct benefit to the member. The problem here is the matching of costs payable by the Nigerian subsidiary with the nature and quantum of benefits received. To the area of concern is in the cost-contribution arrangement, where the Nigerian subsidiary may be able to pay for R&D without any related benefit.

(d) **Transfer of Intangibles**

Most payment of royalties, copyrights, trademarks, patents, protection costs, corporate logo costs, intangibles involved in manufacturing, advertisement, marketing, software, the right to use industrial, commercial or scientific equipment etc. by MNEs, involve payment between parent firms and their foreign affiliates. The concern of Nigerian authorities is not only with transfer pricing, but also with the type of technology transferred.

Allocation of Expenses

The taxation of the profits of a Permanent Establishment (PE) is on net basis. To this end, Article 7 of the OECD model provides for the allowance of expenses. Paragraph 3 of Article 7 in all Nigerian tax treaties follows the UN model. That serves as clarification of paragraph 2 of the Article, to the effect that the expenses to be allowed must satisfy the following conditions:

(i) That the expenses must be shown to have been incurred for the purpose of the business of the PE, that is, the burden lies on the head office to prove that the expenses are "wholly, exclusively, necessarily and reasonably incurred" in earning the profits of the PE;

(ii) Those expenses actually incurred and related to the activities of the PE are deductible.

(iii) That the ordinary expenses which include “executive and general administrative expenses”, wherever incurred, for the purpose of the PE are to be allowed as cost.

(iv) That deductions not allowed for the determination of the profits of the PE include inter-company royalties, rents and interest on loans, other than bank loans.

(v) That transfer between the head office and PE must be at arm’s length; and

(vi) That commission and fees for specific services rendered are allowable at costs.

Transfer pricing methods and evaluation of taxpayer’s controlled transactions

It may however be difficult to determine and fix appropriate transfer prices which will reflect arm’s length transactions due to unavailability of similar product or services for comparism.

The Nigerian tax legislations have not dealt specifically with the subject of transfer pricing, but there is a general anti-avoidance provision in the tax Acts which empowered the tax authorities to set aside the prices charged in related parties’ transactions if such transactions are not made at arm’s length.

(a) In determining whether the result of a transaction or series of transactions are consistent with the arm’s length principle, one of the following transfer pricing methods shall be applied as recommended in the guidelines issued by OECD:

(i) the Comparable Uncontrolled Price (CUPM) method;

(ii) the Resale Price method;

(iii) the Cost Plus method;

(iv) the Transactional Net Margin method; or

(v) the Transactional Profit Split method; and

(vi) Any other method which may be prescribed by Regulations made by the Service from time to time.

The first three methods and the last two methods are referred to as traditional transaction methods and transactional profit methods respectively.

(b) In each case mentioned above, the most appropriate transfer pricing method shall be used taking into consideration:-

(i) the respective strengths and weaknesses of the transfer pricing method in the circumstances of the case;

(ii) the appropriateness of a transfer pricing method having regard to the nature of the controlled transaction determined, in particular, through an analysis of the functions performed, assets employed and risks assumed by each person that is a party to the controlled transaction;

(iii) the availability of reliable information needed to apply the transfer pricing method; and

(iv) the degree of comparability between controlled and uncontrolled transactions, including the reliability of adjustments, if any, that may be required to eliminate any differences between comparable transactions.

(c) When examining whether or not the taxable profit resulting from a taxpayer's controlled transaction or transactions is consistent with the arm's length principle, the Service shall base its review on the transfer pricing method used by the taxable person if such method is appropriate to the transaction.

(d) A connected taxable person may apply a transfer pricing method other than those listed in the Regulations, if the person can establish that:-

(i) none of the listed methods can be reasonably applied to determine whether a controlled transaction is consistent with the arm's length principle; and

(ii) The method used gives rise to a result that is consistent with that between independent persons engaging in comparable uncontrolled transactions in comparable circumstances.

(e) Where a taxpayer carries out, under the same or similar circumstances, two or more controlled transactions that are economically closely linked to one another or that form a continuum such that they cannot reliably be analysed separately, those transactions may be combined to:

(i) perform the comparability analysis set out in the regulation; and

(ii) Apply the transfer pricing methods set out in the regulation.

Comparable Uncontrolled Price Method (CUPM)

The comparable uncontrolled price method compares the price charged for transactions between associated enterprises (related parties) with prices charged for similar transactions between independent enterprises (unrelated parties) in comparable circumstances. If there is any difference between the two prices, this might be an indication that the transactions between the associated enterprises are not made at arm's length.

In the Regulations, unless the context otherwise requires-

(1) "*Comparable Uncontrolled Price (CUP) Method"* means a method in which the price charged for property or services transferred in a controlled transaction is compared with the price charged for property or services transferred in a comparable uncontrolled transaction.

(2) "*Comparable Uncontrolled Transaction"* for the purposes of the Regulations, means an uncontrolled transaction that-

(i) does not differ significantly from a controlled transaction in a way that could materially affect the financial indicators applicable under the method; or

(ii) Differ, but reasonably accurate adjustments can be made to eliminate the effects of such differences.

The easiest method of determining an arm's-length price in any transaction is to compare the prices paid on a particular transaction with prices which are generally paid on the open market for similar types of transactions between unconnected persons. The principal difficulty with the operation of this method is that the likelihood of finding another transaction where all of the surrounding circumstances, apart from the connection between the parties, coincide with the circumstances surrounding the relevant transaction is remote. The Organization for Economic Co-operation and Development (OECD) recognized the difficulties surrounding this method and identified a number of factors which may affect comparability of transactions, such as the nature of the goods, packaging and brand name.

A review of these factors show clearly how difficult in practice is the comparable transactions method to operate effectively, particularly as the Relevant Tax Authority is likely to be prevented by confidentiality rules from disclosing information concerning the pricing arrangements of other companies who are competing with the company whose pricing arrangements are under investigation. Accordingly, although in theory examination of comparable transactions is the easiest and fairest method of evaluating any transaction under investigation, in practice it will usually be very difficult to operate effectively.

Example;

*A Ltd and B Ltd are members of the same group. If A Ltd sells a particular product to independent parties as well as to B Ltd under similar circumstances, the prices charged for A Ltd's sales to independent parties can be compared with prices charged for A Ltd's sales to B Ltd (**internal comparable)**. Similarly, if an independent party (OBI Ltd) sells to another independent party (BUY Ltd) the same product sold by A Ltd, the prices charged by OBI Ltd can also be used as the basis for comparison (**external comparable).** For tax purposes, the tax authority may reject the prices for transactions between A Ltd and B Ltd (associated enterprises) and adopt the prices for transactions between independent enterprises.*

However, in applying the CUP method, it should be noted that prices for the same product may differ not necessarily because of being sold to associated or independent enterprises, but because the product is not sold under similar terms and circumstances in comparable quantities and markets. Therefore, it may be necessary to make reasonable comparability adjustments for such differences.

Although the method appears to be attractive, it requires great attention in order to ensure that true comparability exists; comparability should exist in the market conditions (i.e. the levels of demand), the market level (i.e. wholesale or retail), the goods being compared, the volumes of goods ordered (a large order attracts a discount).

Resale Price Method (RPM)

"*Resale Price Method"* means a method in which the resale margin that a purchaser of property in a controlled transaction earns from reselling the property in an uncontrolled transaction is compared with the resale margin that is earned in a comparable uncontrolled purchase and resale transaction.

The critical issue in arriving at an arm's-length price using this method is the appropriate level of profit margin for the purchasing company. Factors which frequently are taken into account include:

(1) The exclusiveness of the purchaser's marketing rights;

(2) The level of risk assumed by the company which will sell the goods into the open market; and

(3) The amount of work, if any, performed by the purchasing company on or in respect of the goods in question.

Determining the level of profit invariably involves comparison with similar transactions undertaken by other companies. This brings the Federal Inland Revenue Service back to the practical difficulty of obtaining the necessary information to make this comparison.

Example:

A Ltd and B Ltd are related companies. A Ltd transfers goods to B Ltd which B Ltd sells to independent parties. Under the resale price method, the arm's length price of the product acquired by B Ltd in a non-arm's length transaction is determined by reducing the price realized on the resale of the product by B Ltd to independent parties by an appropriate gross margin (resale price margin). B Ltd's gross margin may be determined by reference to the gross margin that B Ltd usually earns in comparable transactions with independent parties (internal comparable), or by reference to the gross margin earned by independent enterprises in comparable transactions (external comparable) within the industry.

Cost-Plus Method (CPM)

Under this approach, the costs incurred by the supplier in making the product transferred or services provided to an associated enterprise are ascertained and marked-up. An appropriate mark-up may be determined by reference to other enterprise in similar independent supplier earns in comparable transactions (internal comparable), or by reference to the mark-up earned in comparable transactions by entirely independent enterprises (external comparable).

"Cost Plus Method" means a method in which the mark up on the costs directly or indirectly incurred in the supply of goods, property or services in a controlled transaction is compared with the mark up on those costs directly or indirectly incurred in the supply of goods, property or services in a comparable uncontrolled transaction.

The OECD has acknowledged the difficulties of operating this method in isolation and, in particular, has identified a number of disadvantages of the method. For example, this method: (1) overemphasizes historical cost, (2) ignores user demand, (3) fails to reflect competitive conditions adequately, (4) assumes a guaranteed profit in all circumstances, and (5) ignores abnormal factors such as increased costs due to poor management. Notwithstanding these stated difficulties, the method is used particularly in circumstances where the resale prices method is inappropriate-for example, on a sale of semi-finished products between connected parties, perhaps involving further processing by the purchaser-or as a method of checking figures obtained under one of the other methods.

However, regardless of the method adopted, the Federal Inland Revenue Service has stated that it will be guided by the principles set out by the OECD in arriving at an arm's-length price. On this basis the following principles are applied in practice:

(1) The Revenue authorities should not form their own commercial judgment on any transactions and should rely on real and not hypothetical cases in reaching their evaluation.

(2) Reasonable and consistently applied pricing arrangements should not, as a general rule, be challenged, even where on occasions such arrangements give rise, for whatever reason, to an unusually high or low price.

(3) Subsidies, grants and price controls, other than those imposed between connected parties, should be taken into account.

(4) All benefits, and not just pure profit or loss accruing to either party must be given appropriate consideration. For example, under certain circumstances it should be possible to justify uneconomic pricing policies where such policies are part of a long-term coordinated strategy within the multinational group involved.

In this way it is hoped that commercial realities can be observed whilst, at the same time, the aims of the transfer pricing rules, namely, to "ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activities deployed by taxable persons in Nigeria, including in their transactions and dealings with associated enterprises" can be achieved.

Example:

D Ltd and G Ltd are related companies; D Ltd transferred 10,000 units of its product to G Ltd at N500 per unit. The direct costs incurred by D Ltd to produce the product amounted to N400 per *unit. The arm's length mark-up earned by companies producing / selling similar product to independent parties is 45%. Therefore, the tax authority will recognize D Ltd.'s sales to G Ltd as N5,600,000 (i.e. 10,000 units x N400 x 145%) instead of N5,000,000 (i.e. 10,000 units x N500). If the method uses direct costs as in the example, then, the mark-up should cover indirect costs, overheads and profit.*

Further example; A Ltd and B Ltd are related companies. A Ltd transferred 5,000 units of a product to B Ltd at N400 per unit. The direct costs incurred by A Ltd to produce the product amounted to N350 per unit. The arm's length mark-up earned by companies producing/selling similar product to independent parties is 40%. Therefore, the tax authority will recognize A Ltd's sales to B Ltd as N2,450,000 (i.e. 5,000 units x N350 x 140%) instead of N2,000,000 (i.e. 5,000 units x N400). If the method uses direct costs as in the example, then, the mark-up should cover indirect costs, overheads and profit.

Transactional Net Margin Method (TNMM)

"***Transactional Net Margin Method"*** means a method in which the net profit margin relative to the appropriate base, including cost, sales or assets that a person achieves in a controlled transaction is compared with the net profit margin relative to the same basis achieved in a comparable uncontrolled transaction.

An appropriate net margin may be determined by reference to the net margin that the enterprise earns in comparable transactions with independent enterprises (internal comparable), or by reference to the net margin earned in comparable transactions by independent enterprises (external comparable). The transactional net margin method operates in a manner similar to the cost plus and resale price methods. However, the transactional net margin examines the net profits in relation to an appropriate base (e.g. costs, sales, assets) and not gross margin on resale or mark-up on costs.

Transactional Profit Split Method (TPSM)

The first step is to determine the combined profit that arises from a business transaction in which the associated enterprises are engaged. This profit is then split between the associated enterprises in a manner that reflects the division of profit that would have been expected between independent enterprises. The combined profit or loss attributed to the transactions in which the associated enterprises participated is allocated to the associated enterprises in proportion to their respective contributions to that combined operating profit or loss.

Transaction pricing manipulation

Transfer pricing has come to stay in Nigeria and would continue to be a tax issue particularly in view of the motivation for transfer pricing manipulation. It is the over or under invoicing of transfer price in order to avoid or evade tax regulations and policies. This is done by deliberate setting of transfer prices either too high or too low in order to avoid or evade tax.

The motivations for transfer price manipulation are:

1. Through under invoicing, the Multinational Enterprises can avoid paying customs duties.
2. By shifting tax-deductible costs to the high-tax country and taxable revenue to the low-tax country, the Multinational Enterprises can minimize the total tax paid to the two countries.
3. If the foreign subsidiary cannot directly remit profits to its parent firm because of host Country's foreign exchange restrictions, profits can be shifted out of the host country by over invoicing, intra firm exports to, and under invoicing, exports from, the foreign affiliate.

It is with this likelihood of manipulation that has led to the provision of penalties to deal with these transgressors.

Offences, penalties and dispute resolution

A taxable person who contravenes any of the provisions of the Regulations shall be liable to a penalty as prescribed in the relevant provision of the applicable tax law. The Federal Inland Revenue Service shall set up a Decision Review Panel ("the Panel") for the purpose of resolving any dispute or controversy arising from the application of the provisions of the Regulations. A taxable person may, within thirty days of the receipt of the assessment on the adjustment refer the assessment to the Panel.

The panel shall in rendering a decision on a matter presented before it take into consideration-

(i) the adjustment or assessment issued;

(ii) the basis on which the adjustment or assessment was issued;

(iii) the taxable person's objection; and

(iv) The evidence presented to it by the parties.

The Panel shall issue a formal adjustment or assessment-

(a) based on the decision rendered by it on matter presented by the parties; or

(b) Where taxable person fails to communicate its decision to refer the assessment or adjustment to the Panel within thirty days of the receipt by the taxable person of the assessment or adjustment.

The decision of the Panel on any adjustment or assessment before it shall be final and conclusive without limiting the right of a taxpayer to refer the matter, where dissatisfied with the decision of the Panel to a court of competent jurisdiction.

Transfer Pricing Planning

The first planning option is provided by the safe harbor provisions in paragraph 15 of the Regulations in which a connected person may be exempted from the requirements for documentation and disclosure where-

(a) the controlled transactions are priced in accordance with the requirement of Nigerian statutory provisions, or

(b) The prices of the connected transactions have been approved by other Government regulatory agencies or authorities established under Nigerian law and satisfactory to the Service to be at arm's length.

The second option is policy consistency and every multinational group should examine on a regular basis its intra-group pricing policies to ensure that they are clearly established and able to stand up to detailed investigation. The polices should, wherever possible, be documented and should be applied consistently with no exceptions to the stated policies being clearly justifiable. Where possible, any major transactions between connected entities which may be vulnerable should be documented individually, and any unusual items or considerations involved in the transaction highlighted with the thought process behind them made clear.

The third option is the application of UN and OECD Transfer Pricing guidelines. The OECD has produced a number of reports on transfer pricing which examine the area in some detail and which throughout give practical information which may provide guidance when seeking to establish and maintain a transfer pricing policy. The reports provide at least, an invaluable bench mark against which multinational groups can start to evaluate their own pricing policies.

It must however be noted that where any inconsistency exists between the provisions of any applicable law, rules, regulations, the UN Practical Manual on Transfer Pricing, the OECD documents referred to regulation 11 of the regulations, the provisions of the relevant tax laws shall prevail. The provision of this regulation shall prevail in the event of inconsistency with the other regulatory authorities' approvals.

Power to make Regulations

The power to make regulations and under which the Income Tax (Transfer Pricing) Regulations of 2012 was enacted is contained in Section 61 of the FIRS (Establishment) Act of 2007 and provides that the Board may, with approval of the Minister, make rules and regulations as in its opinion are necessary or expedient for giving full effect to the provisions of this Act and for the due administration of its provisions and may in particular, make regulations prescribing the-

(a) forms for returns and other information required under this Act or any other enactment or law; and

(b) Procedure for obtaining any information required under this Act or any other enactment or law.

The question is, in making these regulations was the Minister of Finance acting within the powers conferred by section 61 or was the Minister simply making new laws and acting beyond the powers conferred by the Act?

Nigeria is not alone in making of Transfer Pricing rules by way of Executive or Ministerial Regulations as countries like Kenya which enacted the Income Tax (Transfer Pricing) Rules of 2006 and Uganda which enacted their own Transfer pricing regulations in 2011 were all made by Executive Regulations. However, in some Countries the transfer pricing rules are enacted as part of the Income Tax Code such as South Africa by way of Section 31 of the Income Tax Act 58 of 1962 and Namibia through Section 95 of the Income Tax Act of 2005.

ISSUES IN TRANSFER PRICING

Arm's Length Principle

The "arm's length principle" requires that the conditions of a controlled transaction should not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances. In effect, the arm's length principle would be said to be at play where the relationship (or lack of it), existing between parties to an economic transaction, have not impacted on the prices chargeable or payable by the respective party. Where parties to a transaction are related or otherwise connected, the transactions must be priced as with those between independent enterprises conducted in similar circumstances.

An arm's length price for a transaction is what the price of that transaction would accord with arm's length principle. The arm's length principle provides the basis for taxing income derivable from transactions between associated enterprises in most countries. This principle is further captured in Article 9 of the OECD and UN Model Tax Conventions as well as OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

Every taxpayer is expected to comply with arm's length principle in dealing with transactions between related entities. The Enterprise and Multinationals are expected to be guided with the following principles.

(a) Where a connected taxable person has entered into a transaction or a series of transactions to which the Regulations apply, the person shall ensure that the taxable profits resulting from the transaction or transactions is in a manner that is consistent with the arm's length principle (TP Regulation, 2012).

(b) Where a connected taxable person fails to comply with the provisions of the Regulation, the Service shall make adjustments where necessary if it considers that the conditions imposed by connected taxable persons in controlled transactions are not in accordance or consistent with the "arm's length principle".

Transfer Mispricing

Transfer mispricing occurs where transfers are priced arbitrarily without regard to the contributions (assets employed and risk borne) of the respective parties to the transaction. Entities are tempted not to make use of prices determined based on the arm's length principles for the following reasons:

(a) To take advantage of difference in corporate tax rate; especially where tax incentives apply in certain jurisdiction;

(b) To minimize the effect of high customs duty and other indirect taxes;

(c) To circumvent ownership and profit repatriation restrictions;

Documentation

It is the responsibility of taxpayers to keep records that are considered adequate for the purposes of proving that transfer prices conform to the arm's length principles. Such records must be kept for a minimum period of 6 years. Documents and analysis must be provided to FIRS within 21 days of request subject to the discretion of the Service on extension. The burden of proof of compliance with arm's length principle is on the taxpayer but discharged upon the provision of relevant documents. The documents will include:

(a) Transfer Pricing Policy

(b) Transfer Pricing Compliance Report

(c) Transfer Pricing Returns i.e. TP declaration and disclosure forms.

Transfer Pricing Policy

A transfer pricing policy is a document that guides the conduct of related party's transaction within a group of companies. There are two types of transfer pricing policy:

(a) Group Transfer Pricing Policy, and

(b) Local Transfer Pricing Policy.

Features of a Transfer Pricing Policy are:

- Typically prospective in nature
- Typically not updated unless there are significant changes in business
- Provides a future view of likely intercompany transactions
- Provides guidance on pricing of the transactions and methodology.

Transfer Pricing Disclosure and Submission to FIRS

The Federal Inland Revenue Service expect all taxpayers to develop appropriate transfer pricing policy and provide relevant information to be stated in a specified manner in the Transfer Pricing Disclosure and Declaration forms as follows:

(a) Particulars of Reporting Company or Entity

(b) Particulars of immediate Parent Companies

(c) Particulars of Directors of Reporting Companies

(d) Particulars of major Shareholders of Reporting Companies and Related Parties

(e) Ownership, Structure of Reporting Entity and Related Parties

(f) Particulars of Subsidiary and other Connected Persons

(g) Particulars of External Auditors of Reporting Entity

(h) Particulars of Tax Consultant of the Reporting Entity

(i) Particulars of Company Secretary of the Reporting Entity

(j) Particulars of the person making the declaration.

Transfer Pricing Returns i.e. TP declaration and disclosure forms.

Filing Tax Returns

Challenges of Setting Appropriate Transfer Price

Most transfer pricing issues involve significant transactions between related parties where one or more parties are in low tax jurisdictions (such as Africa) e.g. representative office, sole dealership etc.

The major problems associated with the process are:

- In the event of transfer of intangibles to related enterprises –difficulty in valuation;
- For specific service charges (e.g. interest, insurance premiums, royalties etc.) to related parties – how to quantify value addition
- With respect to shared services – relationship of the service with resulting income and whether the service provider should charge market prices.

If market prices are fixed, can an entity (group) make profit from itself? How will resultant income tax paid on notional profits be treated?

- Business restructurings – determining the appropriate prices for second-hand assets transferred to associated companies.
- Loss making and loss merging – should business not have the liberty of merging losses within the group?
- Effective tax rate – multinational enterprises do set for themselves acceptable effective tax rate. One way of keeping within this effective rate is to shift profits from high tax-rate jurisdictions to low tax-rate ones.
- Poor/non-existent documentation – globally, transfer pricing documentation is still a major challenge. Many transfer pricing audits are done years after the transactions have been closed.
- Excessive debt - certain industries rely greatly on debt funding (technology, oil & gas etc.).

Consequences of Manipulating Transfer Pricing in Nigeria

(a) Distortions in Balance of Payments – overpricing of imports

(b) Inequity of the poor subsidizing the rich

(c) Unintended funding

(d) Market distortions due to unfair competition

(e) Blockade of fresh capital inflow (recycling of internal funds)

Key definition and other issues to be considered in transfer pricing

Controlled Transaction: Transaction which constitutes commercial or financial transaction between connected taxable persons.

Connected Taxable Persons: Connected Taxable Persons include persons, individuals, entities, companies, partnerships, joint ventures, trust or associations (collectively referred to as "Connected Taxable Persons"). Also includes the persons referred to in sections 13,18 and 22 of CITA, section 15 of PPTA, section 17 of PITA, article 9 of OECD Model Tax Convention and "associated enterprise" in OECD guidelines.

The following persons will be regarded as Connected Taxable Persons (i.e. related parties) within the context of the TP Regulation 2012;

(a) Any entity dealing with a related party (associate, subsidiary, joint venture)

(b) A members of a local group of companies

(c) Members of a conglomerate

(d) Multinationals

(e) An entity in a group located in the free zone

(f) A group entity that has a pioneer status

(g) Intra company profits which is taxable under different regimes e.g. tax exempt export profits

(h) Loss making entity within a profitable group

(i) Related parties subject to tax at different rates

(j) Permanent establishment.

- Inter-company transfers: Transfer of goods, services, intangibles, intellectual property rights or loans between related entities
- Intra-company transfers: Transfer of goods, services, intangibles, intellectual property rights or loans between responsibility centers within an entity.
- Safe Harbor: This refers to exemption from documentation requirements under the Nigerian TP regulations.
- Independent enterprises or persons: Enterprises or persons that are not connected, related or otherwise associated with one another.
- Comparable Uncontrolled Transaction: This refers to a transaction that;

(i) Does not differ significantly from a controlled transaction in a way that could materially affect the financial indicator applicable under the method; or

(ii) is different from a controlled transaction, but for which reasonable accurate adjustments can be made to eliminate the effects of such differences.

Arm's length comparability factors in transfer pricing

The FIRS, in determining whether a transaction has been conducted at arm's length will consider the following on a comparative basis:

(a) The similarity or identical nature of the transaction to that entered into by an unconnected taxable person;

(b) The facts and circumstances of the transactions per economic relevance;

(c) The characteristics of the goods, property or services transferred or supplied;

(d) The functions undertaken by the person entering into the transaction per resources expended and the risks assured;

(e) The contractual terms of the transactions;

(f) The economic circumstances in which the transactions take place; and

(g) The business strategies pursued by the connected taxable persons to the controlled transaction.

Administration of transfer pricing regulation

The following areas are to be noted and complied with by the taxpayers and tax practitioners in Nigeria.

Annual Transfer Pricing Returns: A connected taxable person must submit TP documents annually to FIRS and Transfer Pricing disclosure and declaration forms are to be attached to the annual tax returns.

(a) Administrative Procedures: Transfer Pricing department of FIRS shall review all Transfer Pricing documents submitted and carry out a review of transactions verifying the appropriateness of Transfer Pricing methods adopted.

(b) Burden of Proof: Transfer Pricing document must demonstrate sufficient information and analysis to verify consistency of the taxable profits derived from its controlled transactions with the arm's length principle.

(c) Offences and Penalties: A taxable person who contravenes any of the provisions of Transfer Pricing Regulation shall be liable to a penalty as prescribed in the relevant provision of the applicable tax law – CITA, PITA, PPTA.

Advance Pricing Agreements (APA)

FIRS can enter into APA with taxpayers (for future transactions) on request subject to single minimum transaction value of N250m (approximately US$1.6million) must be met. Generally, APAs between the FIRS and CTPs (Connected Taxable Persons) will have a term of three years unless cancelled under certain circumstances by either the FIRS or the CTPs, or both.

Comparability factors to be used include:

- Physical characteristics of the item transferred.
- Functions performed based on assets used and risks assumed.
- Contractual terms of the transaction.
- Economic circumstances under which the transaction was undertaken.
- Business strategy pursued by the connected taxable persons.

Penalties

The Regulations do not provide for a unique penalty for transfer pricing relying instead on the existing Acts noted above. FIRS will establish a Decision Review Panel (DRP) for the purpose of resolving any dispute or controversy arising from the application of the Regulations. A taxpayer who disagrees with the ruling of the DRP on any transfer pricing matter has recourse to the court of competent jurisdiction in the first instance — which includes the tax tribunals. Taxpayers should note that the provisions related to fraudulent filings are particularly strict in

Nigeria and that to the extent a taxpayer makes a false declaration on a tax return — including indicating on the transfer pricing disclosure form that documentation is in place when it is not —FIRS may impose fines, penalties, and in some cases jail term for company officials.

Responsibilities of Tax payers

With the transfer pricing (TP) regime having been kick-started with the publication of the TP regulations, multinational enterprises should work on the following issues:

- Establish Group TP policy.
- Align group TP policies with the Regulations.
- Set up internal structures to handle TP policies, documentation and reporting
- Design internal control and reporting system for controlled transactions.
- Secure services of TP professionals to handle negotiation, documentation, analysis and filing of activities.
- Ensure that the contracts for all intra-group transfers are properly documented
- Secure TP compliance personnel.

11.06 Thin Capitalization

According to CITN (2008, p.31), "where a company is heavily financed by debt as against equity, the company is said to be thin capitalized. This is because the proportion of the company's capital is more of debt than equity". Let us discuss this topic with special emphasis on multinational enterprises. A company may be financed mostly through equity or debt. For example, a multinational company which has its head office outside Nigeria may decide to provide additional funds to its Nigerian subsidiary by way of a loan rather than acquiring additional shares in the subsidiary. This may lead to the parent company's debt representing a higher proportion of the subsidiary's total capital than would be normal if the debt finance were provided by an independent party.

Tax Implications of Thin Capitalization

A lender earns interest on the loans granted to a company while a shareholder earns dividend as a return on its investment. A company has a legal obligation to pay the interest on loan no matter the level of profit or loss. On the other hand, dividends are paid to the shareholders at the discretion of the management (board of directors). Furthermore, interest on loan is an allowable deduction in ascertaining assessable profit for tax purposes, whereas dividends are not. It is, therefore, to the advantage of the parent company to finance a Nigerian subsidiary with more loan than equity. The parent company can repatriate more of the subsidiary's profits by way of interest, thus leaving lower profits to be taxed in Nigeria. Thus the tax charged is shifted from the jurisdiction where the investment is made to that of the investor. Arogundade (2005,p.88) remarked that:

Where there are no rules to deal with thin capitalization, as in Nigeria, the choice

of debt finance by the head office of a MNE will lead to the stripping of Nigerian profits and consequently lead to loss of revenue to government.

Example: A UK company establishes a subsidiary in Nigeria. The subsidiary requires a capital of N100,000,000 and the market interest rate is 15% a year. The tax rate in Nigeria is 30%. The subsidiary generates an annual profit before interest and tax of N20,000,000. If the required fund is provided as share capital, the tax on the subsidiary will be N6,000,000 (i.e. 30% x N20,000,000). On the other hand, if three-quarter of the required capital is injected by the parent company as a loan at 15% per annum, the tax on the subsidiary will be reduced to N2,625,000 as shown below. Of course, the subsidiary will deduct withholding tax of N1,125,000 from the interest payable to the parent company.

	₦	
Profit before interest and tax		20,000,000
Less interest (3/4 x 100,000,000 x 15%)	11,250,000	
Taxable profit	8,750,000	
Income tax (30% x 8,750,000)	2,625,000	

We can see the negative effect of the loan on Nigeria. The parent company has been able to repatriate more of its subsidiary's profits by way of interest, thus leaving lower profits in Nigeria for companies' income tax. This enables the tax charged to be shifted from the jurisdiction where the investment is made to that of the investor, allowing more flexible tax planning.

Some countries have made specific rules or provision in their tax legislation to reduce the problem of thin capitalization. Some of these rules are:

(a) Limitation on debt to equity ratio, for example, 3:1, 2:1,1.5:1, etc.

(b) Limitation on deductibility of interest, for example, interest allowable for tax purposes is restricted to 30% of taxable profit before interest and taxes. Interest in excess of the prescribed level is disallowed as a deduction.

(c) Arm's length measure for interest rate, for example, interest rate is limited to the interest rate that the borrower could have obtained from an independent (third-party) lender or an average of rates charged by lending institutions.

There is no specific rule or provision in the Nigerian tax legislation to combat thin capitalization except the general provision in section 22 of CITA 2004 which deals with artificial or fictitious transactions. There is need to introduce thin capitalization rules into our tax laws to ensure that foreign investors do not finance their Nigerian companies with loans which are in excess of arm's length standard by reference to both the amounts and terms of the loans.

11.07 Review Questions

Question 1

Discuss any THREE areas in which the operations of multinational companies in Nigeria could constitute difficulties in the determination of their tax liabilities to the Nigerian Government;

Question 2

In respect to Transfer Pricing Regulations in Nigeria;

(a) Describe the following:

i. Arm's Length Price

ii. Items that constitutes Controlled Transactions

(b) Mention any TEN main items that will feature in the disclosure and declaration forms to be submitted to the Federal Inland Revenue Service.

Question 3

(a) Briefly explain a transfer pricing document.

(b) State any THREE key transfer pricing documentation.

(c) State key features of a transfer pricing policy

Question 4

In relation to Transfer Pricing regulations in Nigeria, describe “Connected Persons” and enumerate what constitute: Connected Persons as stated in provisions of CITA, PPTA, PITA and OECD Guidelines.

Question 5

UAC incorporated of USA has ABUJA Nigeria Limited as its subsidiary in Nigeria. The foreign company was awarded a road construction contract by the Federal Government of Nigeria at a total sum of N15 billion on 1st January, 2009. The company sub-contracted the job to ABUJA Nigeria Limited at N12 billion. Both companies enter into a technical service agreement under which the parent company will provide equipment and technical personal for the execution of the contract.

The contract was successfully executed by ABUJA Nigeria Limited during the year ended 31st December, 2009 and the Income Statement of the company showed the following:

		N
Turnover		12,000,000,000
Less:	Cost of Materials	1,510,000,000
	Hire of equipment	1,000,000,000
	Technical personnel cost	1,355,000,000
	Other administration expenses	1,023,000,000
	Depreciation	410,000,000
Net profit		6,702,000,000

Notes:

i. The equipment hired from the parent company at N795 million could have been hired from another company at N600 million.

ii. If the parent company did not provide the technical personnel, ABUJA Nigeria limited could have employed the same personnel at N450 million.

iii. Capital allowances for the year have been agreed at N65,000,000.

iv. The contract fees were subject to withholding tax.

v. The capital requirement of the company is N60,000,000 and 80% was supplied by UAC USA at an interest rate of 20%. The interest expense is embedded in adm. Expenses.

vi. Assume that FIRS operational guide requires capitalization at a ratio of 1: 2 as in equity to external funding.

Required:

(a) Compute the income tax payable by Bush Nigeria Limited for the relevant year of assessment.

(b) Compute the income tax payable by UAC in Nigeria for the relevant year of assessment.

Question 6

The following is a summary of the profit or loss account of Josiah Nigeria limited, a Nigeria company, for the year ended 31st December, 2013.

	N	N
Gross profit from Nigeria operations		2,500,000
Less expenses from Nigerian operations:		
Administration expenses	580,000	
Selling and distribution expenses	820,000	
Finance charges	350,000	
Depreciation	110,000	

Donations to political parties	100,000	1,960,000
Net profit from Nigeria operations		540,000
Profit from branch in Belgium		400,000
Net profit from Nigerian and foreign operations		940,000

Additional information:

(a) Tax paid by the company to the Government of Belgium amounted to N112,000.

(b) There is a double taxation Agreement between Nigeria and Belgium with a standing sum of N75,000.

(c) Capital allowances for the year of assessment were agreed as:

Head office	(Nigeria)	120,000
Foreign branch	(Belgium)	80,000

Required:

Compute the income tax liability of Josiah Limited taking into consideration the double taxation relief.

Question 7

a. The Nigerian Government, worried by the rising incidence of Transfer Pricing abuses by Multinational and Group Companies, issued, through the Federal Inland Revenue Service (FIRS), Income Tax (Transfer Pricing Regulations) 2012.

You are required to explain FOUR objectives of the guideline.

b. On 22 August, 2014, your client HYDRO CARBONS OIL & GAS LIMITED, a subsidiary of a Multinational Company with head office in Germany, received a letter from the Transfer Pricing office of the Federal Inland Revenue Service (FIRS) requesting the Company to forward amongst other requirements, the following:

i. The Company's Transfer Pricing Policy; and

ii. Transfer Pricing Disclosure and Declaration Forms.

The Managing Director on reading the contents of the letter became worried as he could not understand the essence of such requests. As the Tax Consultant to the Company, you are required to:

i. Explain what Transfer Pricing Policy is.

ii. Outline **TEN** items to be included in the Transfer Pricing Disclosure and Declaration forms.

Question 8

You are the Tax Manager of Forum Tax Associates and recently represented your firm at a Workshop organized by the Federal Inland Revenue Service (FIRS), Western Zone, on Transfer Pricing Regulations in Nigeria. The Workshop was to create awareness on the filing requirements and compliance with the provisions of "The Income Tax (Transfer Pricing) Regulations 2012". The Workshop which was held on the 20th Floor of the Nigeria Stock Exchange building was fully attended to by Company Auditors, Tax Practitioners, Stock Brokers, Bankers and other Stakeholders. From the notes you took at the Workshop, you presented a report to the Managing Partner, Forum Tax Associates, on Wednesday, 3 September 2014. The Managing Partner thanked you for a good job and highlighted some key areas of the regulations that will serve as a guide to the staff of the firm.

You are required to prepare a technical briefing for the staff explaining the following key areas noted by the Managing Partner:

(a) Objectives of the application of Transfer Pricing Regulations.

(b) Treatment of Permanent Establishment.

(c) Contents of a Transfer Pricing Disclosure to be submitted by Companies to the FIRS.

SUGGESTED SOLUTIONS

SOLUTION 1.

The following are some of the areas which could constitute difficulties in the determination of tax liabilities of multinational companies operations in Nigeria.

(a) Different Pricing of Goods / Services at Purchase Cost In a multinational group, one member of the group in one country may supply goods or services to another member in another country. The prices charged create sales revenue for the company selling the goods or services and purchase cost for the company buying the goods or services. These will eventually affect the profits of each company which are accountable to different tax jurisdictions.

Example:

A multinational company has its subsidiary in Nigeria and head office in Country UK. The Nigerian subsidiary charges low prices (below open market prices) for goods supplied to the parent company in country UK. On the other hand, the parent company overcharges the Nigerian subsidiary for services rendered to the subsidiary. Consequently, the Nigerian subsidiary records low profits and pays less tax to the Nigerian Government, while the parent company declares more profits and pays more tax to the tax authority in UK. As rightly pointed out by many authors, what Nigeria loses through the shift of profit is a gain to UK to which the profit is shifted.

(b) Tax Fraud

Transfer prices have serious tax implications and multinational transfer pricing can provide an avenue for tax fraud. Companies within the same group which are under different tax jurisdictions may decide to overprice or under-price inter-group transactions depending on what they want to achieve.

(c) Custom Duties & Tariff Manipulation

Transfer prices will also affect customs duties paid on imports and exports. For example, if the transfer prices on imports into a country are lowered, the import duties and other tariffs on the imports will equally be reduced.

(d) Dividends Manipulation

Multinational transfer prices may also be influenced by dividend considerations. Consider a situation that Nigeria puts a restriction on the amount that a company can pay out as dividend to parties outside the country. A parent company based in Germany may decide to overprice goods and services transferred to its subsidiary in Nigeria. In that way, more funds leave the subsidiary company in Nigeria to Germany without appearing to violate the dividend restriction.

(e) Imposition of Excessive charges

The parent company can also impose excessive charges (e.g. royalties) on its foreign subsidiaries, associates, etc. in respect of the provision of intangibles such as patents, licenses, trademarks, etc. and use these avenues to siphon funds to tax heavens or jurisdictions with favourable tax requirement.

Where the head office of the multinational or a member of the group incurs expenses which are for the benefits of all or many members of the group; the allocation of the joint costs to members of the group will certainly affect their profits and taxes.

In a global economy where multinational enterprises (MNEs) play a prominent role, governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein. For taxpayers, it is essential to limit the risks of economic double taxation that may result from a dispute between two countries on the determination of the arm's length remuneration for their cross-border transactions with associated enterprises as expressed by OECD.

There are provisions in the Nigerian tax laws which give the relevant tax authority power to make appropriate adjustment to counteract the reduction or would be reduction in tax liability where transactions between connected persons or related parties are not made at arm's length and the tax authority feels that such transactions are made to reduce the tax liability.

SOLUTION 2.

(a) i. Arm's Length Price is the price charged for the transfer of goods, services or intangible property between connected taxable persons which corresponds to the price that would have been charged by independent persons under similar circumstance.

ii. Items that constitute Controlled Transactions are:

- Sale and purchase of goods and services
- Sale, purchase or lease of tangible assets

- Purchase, licence of intangibles
- Provision of services
- Lending and/or borrowing
- Manufacturing arrangement
- Any other controlled transaction which may affect statement of comprehensive income such as management and technical services, etc.

(b)

(i) Particulars of Reporting Company or Entity

(ii) Particulars of immediate Parent Companies

(iii) Particulars of Directors of Reporting Companies

(iv) Particulars of major Shareholders of Reporting Companies and related parties

(v) Ownership, Structure of Reporting entity and related parties

(vi) Particulars of Subsidiary and other connected persons

(vii) Particulars of External Auditors of reporting entity

(viii) Particulars of Tax Consultant of the Reporting Entity

(ix) Particulars of Company Secretary of the Reporting entity Particulars of the person making the declaration.

SOLUTION 3

(a) A transfer pricing policy is a document that guides the conduct of related parties transaction within a group of companies. There are two types of transfer pricing policy: (i) Group Transfer Pricing Policy (i) Local Transfer Pricing Policy.

(b) Transfer Pricing documentations are:

(i) Transfer Pricing Policy

(ii) Transfer Pricing Compliance Report

(iii) Transfer Pricing Returns i.e. Transfer Pricing Declaration and Disclosure form

(c) Key features of a Transfer Pricing Policy are:

(i) Typically prospective in nature

(ii) Typically not updated unless there are significant changes in business

(iii) Provides a future view of likely intercompany transactions

(iv) Provides guidance on pricing of the transactions and methodology.

SOLUTION 4

Connected Taxable Persons include persons, individual, entities, companies, partnerships, join ventures, trust or associations (collectively referred to as "Connected Taxable Persons"). Also includes the persons referred to in section 13, section 22 of CITA, section 15 of PPTA, section 17 of PITA, article 9 of OECD Model Tax Convention and "associated enterprise" in OECD guidelines.

The following persons will be regarded as Connected Taxable Persons (i.e. related parties) within the context of the TP Regulation 2012.

(a) Any entity dealing with a related party (associate, subsidiary, joint venture)

(b) A members of a local group of companies

(c) Members of a conglomerate

(d) Multinationals

(e) An entity in a group located in the free zone

(f) A group entity has a pioneer status

(g) Intra company profits is taxable under different regimes e.g. tax exempt export profits

(h) Loss making entity within a profitable group

(i) Related parties subject to tax at different rates

(j) Permanent establishment.

SOLUTION 5

ABUJA Nigeria Limited

Computation of Income Tax Liability for 2010 Year of Assessment

	N'm	N'm
Net Profit as per account		6,702
Add Disallowable Expenses:		
Depreciation	410	
Technical personnel cost (1,355 - 450)	905	
Hire of Equipment (795 - 600)	195	
Excess interest charged	1.6	1,511.6
Adjusted Profit/Assessable Profit		8,213.6
Less Capital Allowance		65
Chargeable Profit		8,148.6
Chargeable Tax at 30%		2,444.58
Less Withholding Tax at 5%		600
Tax Payable		N1,844.58

Workings:

1. Interest on Excess Capital at interest rate of 20%.

N8,000,000 x 20% = N1,600,000

SOLUTION 6

Josiah Limited

Computation of Tax Liability for the Year 2014

		N	N
Net Profit as per account			540,000
Add back:	Depreciation	110,000	
	Donations	100,000	210,000
Adjusted Profit			750,000
Profit from Belgium			400,000
Assessable Profit			1,150,000
Less Capital Allowance:			
	Josiah	120,000	
	Belgium	80,000	200,000
Taxable Profit			950,000
Chargeable Tax: 30% of Taxable Profit			285,000
Less Double Taxation Relief			75,000
	Tax Payable		N210,000

SOLUTION 7

(a) The Income Tax (Transfer Pricing Regulations) 2012 issued by the Federal Inland Revenue Service and gazetted in September 2012 as Income Tax Transfer Pricing

Regulations Act of 2012 stated the objectives as:

(i) To ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activities deployed by taxable persons in Nigeria, included in their transactions and dealings with associated enterprises.

(ii) To provide the Nigerian authorities the tools to fight tax evasion through over or under-pricing of controlled transactions between associated enterprises.

(iii) To reduce the risk of economic double taxation.

(iv) To provide a level playing field between multinational enterprises and independent enterprises doing business within Nigeria; and

(v) To provide taxable persons with certainty of transfer pricing treatment in Nigeria.

(b) CHIDIEBERE OIL & GAS LIMITED

(i) Transfer Pricing Policy

This is a document required to be filed with the Transfer Pricing Unit of the FIRS. It contains information that guides the conduct of related parties' transactions within a group of Companies.

There are two types of Transfer Pricing Policies namely:

(i) Group Transfer Pricing Policy

(ii) Local Transfer Pricing Policy

(ii) Transfer pricing disclosure and declaration forms contents for submission to the firs

The FIRS also requires affected Companies, in addition to developing appropriate Transfer Pricing Policies, to provide relevant information in specified manner in Transfer Pricing Disclosure and Declaration Forms which must contain the following:

· Particulars of Reporting Company or Entity.

· Particulars of immediate Parent Companies.

· Particulars of Directors of Reporting Companies.

· Particulars of five major Shareholders of Reporting Companies and Related Parties.

· Ownership Structure of Reporting Entity and Related Parties.

· Particulars of Subsidiary and other connected persons.

· Particulars of External Auditors of reporting entity.

· Particulars of Tax Consultant of the reporting entity.

· Particulars of Company Secretary of the reporting entity.

· Particulars of the person making the declaration.

SOLUTION 8

(a) Objectives

The objectives of the regulations are to:

(i) Ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activities deployed by taxable persons in Nigeria, including on their transactions and dealings with associated enterprises;

(ii) Provide the Nigerian authorities with the tools to fight tax evasion through over or under pricing of controlled transactions between associated enterprises;

(iii) Provide a level playing field amongst multinational enterprises and independent enterprises doing business within Nigeria and

(iv) Provide taxable persons with certainty of transfer pricing treatment in Nigeria.

(b) Treatment of Permanent Establishment

i. A fixed base through which the business of an enterprise is wholly or partly carried on is treated as a permanent establishment.

ii. For the purpose of Transfer Pricing, any transaction between a Permanent Establishment and its Head Office or other connected taxable persons shall be considered to be a controlled transaction.

iii. Such controlled transactions will require the necessary documentation to prove that the transactions have been carried out at arm's length.

(c) Contents of a Transfer Pricing

Disclosure to be submitted to Federal Inland Revenue Service (FIRS)

The Federal Inland Revenue Service Transfer Pricing Disclosure and Declaration form contain the following information:

i. Particulars of Reporting Company or Entity.

ii. Particulars of immediate Parent Company

iii. Particulars of Directors of Reporting Company

iv. Particulars of major Shareholders of Reporting Companies and related parties

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MODULE 12

12.00 TAXATION OF MERGER AND ACQUISITION

12.01 Learning outcome

On successful completion of this Module, Students should be able:

i. Evaluate the meaning of mergers and acquisitions;

ii. Examine the reasons for mergers and acquisitions;

iii. Critically analyze the tax implications of mergers and acquisitions.

12.01 Introduction

Many people often use such words as merger, acquisition or takeover in their daily communications, but few have needed to understand how such businesses are actually structured. For tax purposes, the type of business combination will determine the way assessment will be made (commencement and cessation rule). Consequently, the students must have good understanding of tax issues in merger and acquisitions. This module covers; definition and meaning, reasons and tax complication of merger and acquisitions; shareholders gain and managerial gains in merger and acquisitions.

12.02 Definition and Meaning of Merger and Acquisition

Merger is ‘‘any amalgamation of the undertakings or any part of the undertakings or interest of two or companies or the undertakings or part of the undertakings of one or more companies and one or more bodies corporate’’. Simply put, a merger is a combination or integration of existing companies to form a single company. For example, entity A and entity B combined their assets and liabilities to form entity C.

Acquisition is known as take-over. It is the take-over of business entity by one entity of sufficient share in another entity to give the acquiring entity control over that other company. For example entity A acquired assets and liabilities of entity B, and entity B cease to exist while entity A integrate or consolidate the assets and liabilities of entity B in its financial statement.

12.03 Reason for Merger and Acquisition

In what follows, we classify reason(s) for business combination: The major reason is to increase shareholders wealth and managerial gains

Shareholder Gains

Shareholders gains refer to the increase in the market value of the firm due to the Merger. Since the increase in the value of the firm directly benefits its owners (shareholders) it is said that shareholders gain. A firm may increase its market value by increasing its profits. Increasing profits, in turn, is possible by decreasing costs, operating more efficiently, implementing optimal incentives to managers or enhancing market power. The merger rationales that produce gains to shareholders are:

a. Efficiency Gains

Farrell and Shapiro (1990 & 2001), in distinguishing between efficiency gains in technical efficiency and synergies; defined technical efficiency as those that could be obtained by other means than merging, in particular, by internal growth, joint ventures, specialization agreements, licensing, etc. The author believe that, technical efficiency correspond to changes within the joint production capabilities of the merging parties. In the short term, they can be achieved by a reallocation of output across the merging units or scale economies if capital is mobile. In the longer run, they can be achieved by undertaking investment on a larger scale. In the view of the authors, synergy is seen as efficiency obtained through the close integration of the merging firms' hard-to-trade assets, and are inherently merger-specific since such assets cannot be acquired otherwise than merging. The following three drivers that generate efficiency gains belong to the technical efficiencies definition.

- Economies of scale
- Economies of scope
- Economies of vertical integration

b. Synergy Gains

Synergy is efficiency that can only be achieved by merging, that is, they are merger specific. Synergy is generally associated with a shift on the production possibilities of the merging parties that go beyond technical efficiency (associated with changes within the joint production capabilities of the merging parties, i.e., economies of scale or scope). There is a general recognition that synergy involves either a process of learning, the close integration of specific hard-to-trade assets or a transfer of know-how among the merging firms. For example, when a small firm launches a new product but lacks of large scale sales, marketing and reputation, merging with a well-established firm will most probably bring it gains that would have not been possible without merging. The diffusion of know-how, in turn, can be achieved when the merging firms exchange different R&D activities, patents, human skills, and organizational culture. Since these assets are in general non-tradable, firms can benefit from their combination uniquely by merging:

- Diffusion of know-how
- Research and developments (R&D)

c. Cost Savings

Cost savings is a general concept that can be attained in many distinct ways.

What is important for the analysis of merger motives, is to identify the type of cost saving, i.e., if it consists on a reduction of average or marginal costs of production, fixed costs or financial costs. Fixed costs are those that do not vary with production but that are necessary to produce. They include for instance administrative support, public relationships, maintenance of property plant and equipment, salaries, advertising, etc. Average costs vary with production, by definition they are total costs divided by total production. More often employed in the economic literature is the concept of marginal costs which stands for the increase in costs with one extra unit of production. Finally, financial costs refer to those costs that only affect the distribution of costs within the firm's administration but not the cost of production. Thus, whereas financial costs savings do not imply a saving of productive resources in the economy, average or marginal costs savings in the form of economies of scale, scope and vertical integration do. Acquiring a high R&D target or a target with patents instead of directly expending on it is another way of saving costs. Transferring more efficient technology from one firm to another clearly decreases total costs. The elimination of the duplication of fixed costs when merging will, of course, decrease costs as well. Other examples of cost savings that have been proposed as merger motives are:

- Rationalization: That is, shifting production from a plant with higher marginal costs to another with lower marginal costs, without necessarily increasing the joint technological capabilities, is a mean to save costs.
- Purchasing power
- Creating internal capital markets

d. Financial Cost Savings

Too high financial costs may be a motive for merger as well. According to Roller,

Stennek and Verboven (2006), believe that financial costs savings do not generate real cost savings (savings in productions costs); instead, they involve redistributive cost savings. That is, financial costs do not necessarily imply a value increase in the merging entity; they only reflect a redistribution of wealth from shareholders to debt holders. Among other ways they can be attained by saving on:

- Taxes: Mergers before the 1980s were strongly motivated by tax advantages. The reason is that at the time when an acquisition premium was paid above the values at which a company's depreciable assets were recorded in tax accounts, the acquired assets could benefit of higher depreciation charges, protecting the acquirer from tax liabilities. Until reforms were passed, acquiring companies making such acquisitions could normally escape immediate capital gains taxation. Such tax advantages had an important role in many merger decisions, but not critical enough to determine whether merger would or would not occur. Nowadays there is a tax rule that differentiates the tax liability according to the accounting method by which the acquisition is registered (purchase of assets or pooling of interest).
- Interest rates
- Diversification

e. Enhancement or Strengthen Of Market Power

Market power is defined as the ability of a firm or group of firms to raise prices above the level that would prevail under competitive conditions. The ability to exclude competitors is also seen as a result of excessive market power. The scope of enhancement of market power is associated with industry concentration, product differentiation, entry barriers and cost advantages. The market power merger motive in horizontal mergers is the most controversial one. However, as exposed in the following paragraphs, market power is not exclusive to horizontal mergers.

- Through unilateral effects
- Through coordinated effects (or collusion)
- To raise entry barriers

- To spread portfolio
- To obtain multimarket contact

f. Pre-Emptive and Defensive

Fridolfsson and Stennek (2005) propose a merger rational that they call the pre-emptive (or defensive) motive. They develop a model that shows that if being an insider is better than being an outsider, firms will acquire to prevent the target being acquired by a competitor. The reason is that the merged firm will be a more efficient firm (provided cost efficiencies) and will become a more difficult competitor. This will affect the outsider, so preventing being an outsider, firms pre-empt the merger by anticipating the takeover. Other motives in mergers have been interpreted as defensive in the economic literature. The most common of these is the elimination of a significant competitor (a maverick for instance). Such defensive mergers may be seeking for market power enhancement, or may simply be responding to tougher price competition originated from exogenous factors. Defensive mergers have also been proposed as a result of an endogenous market response to exogenous market shocks such as new technological opportunities that increase the potential for innovation.

g. Disciplinary Takeovers:

These takeovers are said to play an instrument for ensuring that managers' actions do not deviate too far from those that would maximize shareholders value. They are thus inspired on the principal-agent theory and proposed as discipline devices from owners (principals) to managers (agents). Motives that pursue managerial gains are also founded in this theory. Their difference is based on that the ones exposed here seek to increase the firm's value whereas those are managers' strategies seeking to increase their own wealth (at the expense of the firm's value).

- Market for corporate control
- Free-cash flow

Managerial Gains

The following proposals of merger motives originate on the theory of the internal inefficiency of the firm, the so-called X-inefficiency first analyzed by Leibenstein (1966). This theory highlights that there is a difference between the efficient behavior of firms, as predicted by economic theory, and what it is observed in practice. The reason is that, in the real world, firms are complex organizations in which there is a separation between shareholders (ownership) and managers (control). In these organizations, the decisions that affect the overall level of efficiency of the firm are taken by managers who might have objectives other than firm's value maximization. This is in turn related to the principal-agent theory that emphasizes the conflicts between shareholders and managers whenever there is incomplete and asymmetric information between them (the manager is usually better informed about his plans). These conflicts arise since shareholders (principal) seek to maximize firm's value and managers (agents) seek to maximize their wage (or their ego). That is the reason why these merger drivers are also known as the agency motive. In the overall, these motives state that the manager is searching for gains at the expense of shareholders gains.

a. Empire Building

Also called the managerial discretion motive, it states that managers' objective is to increase the size of the organization they want to lead. Their goal is to grow and the fastest way to do it is by acquiring. The reason might be that their compensation is directly related to the size of the company they manage. This hypothesis has first been formulated by Mueller (1969).

b. Hubris

This merger driver was first proposed by Roll (1986). The hypothesis states that managers incorrectly believe to be better able to manage other companies. That is, they are overconfident in their managerial abilities and end up overpaying for a target which makes the acquiring firm to lose. In fact, it has been argued that the hubris consequence (acquiring firm losing from the deal) is equivalent to the winner's curse in common value auctions, namely, bidders overpay for the auctioned item. Here, the highest bidder has the highest positive valuation error (reflecting his overconfidence) and wins the target. The result is that shareholders of the acquiring firm lose from the deal because the market reacts to the mistake of the acquiring firm's manager.

c. Risk Spreading Or Diversification

Sometimes the overall investment strategy of the manager to construct an optimal portfolio includes mergers and acquisitions. According to the portfolio theory this is indeed a mean, to diversify risk (by spreading a selected portfolio) and to maximize expected returns. However, sometimes the manager seeks for a personal portfolio rather that an optimal portfolio for the firm. Since he has the power to select the portfolio, personal diversification might be his goal. As mentioned above, competition authorities generally consider overall economic welfare as consumer surplus rather than total surplus and therefore not all the above merger drivers are necessarily relevant for them. For purposes of merger enforcement, the issue that matters is the effect on welfare and not whether the transaction will generate gains to the firm.

We can summarize the reason for merger and acquisition based on the follows theory

- **Monopoly Theory**: Gaining market power.
- **Efficiency Theory**: Operating synergies, financial synergies and management synergies.
- **Valuation Theory**: Bidder managers have better information about the target's financial performance than the stock market.
- **Empire Building Theory**: Planned and executed by managers who maximize their own utility instead of their shareholders value.
- **Process Theory**: Mangers have only limited information and base decisions on imperfect information.
- **Raider Theory**: Managers creating wealth transfers from the stockholders of the companies they bid for.
- **Disturbance Theory**: Merger waves are caused by economic disturbances.

<table>
<tr><td rowspan="5">Merger as rational choice</td><td rowspan="4">Merger benefits bidders</td><td>Wealth transfers from customers</td><td>Monopoly Theory</td></tr>
<tr><td>Net gains through synergies</td><td>Efficiency Theory</td></tr>
<tr><td>Net gains through private information</td><td>Valuation Theory</td></tr>
<tr><td>Wealth transfer from targets shareholders</td><td>Raider Theory</td></tr>
<tr><td colspan="2">Merger benefits managers</td><td>Empire Building</td></tr>
<tr><td colspan="3">Merger as process outcome</td><td>Process Theory</td></tr>
<tr><td colspan="3">Merger as macroeconomic phenomena</td><td>Disturbance Theory</td></tr>
</table>

Source: Trautwein, 1990 and Straub 2007

12.05 Tax Implication of Merger and Acquisition

Statutory Requirement under Companies Income Tax Act (CITA)

The CITA in Section 29(12) Cap (21, LFN, 2004) provides that ‘‘no merger, take-over, transfer or restructuring of the trade or business carried on by a company shall take place without having obtained the Board's direction under sub-section 9 of this section and clearance with respect to any tax that may be due and payable under the Capital Gains Tax Act’’. The implication of this provision is that the approval of the Federal Board of Inland Revenue is a necessary condition for the completion of the process in a merger or acquisition bid. Therefore, no merger or acquisition bids would be fully consummated without the companies involved having obtained the consent from the FIRS.

Procedure for obtaining the Board's Approval

From the start, the merging companies are required to submit to the Board, copies of the scheme of merger and scheme of arrangement on the consolidation request for its study and proper evaluation in order to ensure that taxes which may result from the companies' transactions are correctly assessed and collected. Herein lies the relevance of the Board's powers under section 29(9)(i) to require either of the companies directly affected by any direction which is under the consideration of the Board to guarantee or give security to its satisfaction for payment in full of all tax due or to become due by the company which is selling or transferring such asset or business.

Emergence of a New Company

a. Rendition of Annual Returns

Where a new company emerges from a merger process, then, the new company is expected to file its returns, in line with the provisions of Section 55(3)(b) of CITA. The section provides that ‘ ‘ every new company shall file with the Board, its audited accounts and returns within eighteen (18) months from the date of its incorporation or not late than six (6) months after the end of its first accounting period as defined in section 29(3) of this Act, whichever is earlier’’.

It should however be understood that a mere change of name does not make an existing business entity a new company. Such companies will continue to be treated as old business on on-going concern basis.

b. Basis of Assessment

Commencement rule as provided under Section 29(3) will apply to the new company, except where any of the under-listed circumstances arise:

- Where the merging parties are connected parties, the Board may direct that commencement rule be set aside, in which case, the new company will file its returns as an on-going concern and its assessment will be determined on preceding year basis.
- Where the new business is a reconstituted company, taking over the trade or business formerly run by its foreign parent company.

When an old company is taken over by a new company, the old company is deemed to have ceased business while the new company is deemed to have commenced a new business. The cessation rule will apply to the old company, while the commencement rules will apply to the new company.

Illustration 1:

Anambra Ltd has been in business ending its accounting year every 31st December. The following relate to the company performance.

Period to 31st Dec 2004	3200
Year to 31st Dec 2005	4,800
Year to 31st Dec 2006	5,600
Year to 31st Dec 2007	15,000
Year to 31st Dec 2008	16,500
Year to 31st Dec 2009	14,820

On 1st July 2007, Delta Ltd. A newly formed company bought over Anambra Ltd. Delta Ltd. ending its accounting year 31st December.

Note: The Company's performance is added together (the old and new company)

Required: Calculate the assessable income for the relevant years.

Solution:

Note: You prepare the assessable income for the old (Anambra Ltd) before the assessable income for Delta Ltd.

ANAMBRA LTD.

Calculation of Assessable Income

Year of Assessment	Basis Period	Assessable Income
2005	Preceding Year	
	1/1/2004 – 31/12/2004	3,200
2006	Preceding Year 2005	
	1/1/2005 – 31/12/2005	4,800
2007	Preceding Year 2006	
	1/1/2006 – 31/12/2006	5,600
	Actual 2007 (Year of Cessation)	
	1/1/2007 – 30/6/2007	7,500

Delta Ltd. – Calculation of Assessable Income

2008	1/7/2007 – 31/12/2007	
	($^{6}/_{12}$ x 15,000)	7,500
2009	First 12 months	
	1/7/2007 – 30/6/2008	
	7,500 + ($^{6}/_{12}$ X 16,500)	
	7500 + 82500	15,750
2010	Preceding Year 2009	
	1/1/2009 – 31/12/2009	16,500

C. Claim of Allowances

Companies Income Tax Act (CITA) did not categorically address the value at which assets may be transferred for the purpose of capital allowances claim. However, International Accounting Standard 22 prescribes that in merger accounting, the assets, liabilities and reserves must be recorded at their carrying balances, implying that merger process does not permit the recording of assets at their fair value in the event of consolidation. The new company will therefore not be entitled to any investment allowance claim or initial allowance on the transferred assets; it will only be entitled to claim annual allowance on the Tax Written Down Values (TWDV) of the transferred assets.

d. Unabsorbed Losses and Un-Utilized Capital Allowances Brought Forward

The new company may also not be permitted to inherit the unabsorbed losses and capital allowances of the absorbed companies, except under the following circumstance:

(i) where a reconstituted company is carrying on the same business previously carries on by this company and it is proved that the losses have not been allowed against any assessable profits or income of that company for any such year; in that case the amount of unabsorbed losses shall be deemed to be a loss incurred by the re-constituted company in its trade or business during the year of assessment in which the business commenced.

e. Taxes and Deductibility of Related Expenses

(i) Stamp Duties

Duty payment will arise on the share capital of the new company, subject to the provisions of Section 104 of the Stamp Duties Act, in relation to capital and duty relief.

(ii) Consolidated Expenses

Fees paid to statutory bodies such as SEC, NSE, CBN, Land Authorities etc., including professionals like Accountants, Stockbrokers, Issuing Houses, and Solicitors are regarded as capital in nature and will therefore not be allowed as deductible expenses by virtue of Section 27(a) of CITS.

(iii) Taxation of Consolidation Fees:

Fees paid to professionals for services rendered in connection with consolidation will be subject to VAT and WHT at the rates of 5% and 10% respectively.

f. Tax Indemnification

Section 29(9)(i) of CITA provides that the Board may require the new company to guarantee or give security for payment in full, for any tax due or that may become due by any of the ceased companies.

g. Approval for Pension Scheme

The new company will need to obtain a JTB approval for its staff pension scheme.

Status of a Surviving Company in Relation to Taxation

It is a possibility that one of the merging companies survives and its old name or a new name to inherit the assets, liabilities, reserves and entire operations of the merging parties. Where this happens, the following points must be noted:

(i) The surviving company must file its returns in line with the provisions of section 55(3)(a) of CITA.

(ii) Commencement rules under section 29(3) of CITA will **not** apply to the surviving company, as it will be regarded as an existing company.

(iii) The surviving company will **not** be allowed to claim investment allowance on the assets which were transferred to it and will also not claim initial allowance on such assets.

(iv) The surviving company may however claim annual allowance only on the tax Written down Values (TWDV) of the assets transferred to it.

(v) The surviving company may **not** inherit the unabsorbed losses and capital allowances of the merging companies, except it is proved that the new business is a reconstituted company.

(vi) All fees payable on merger bids or consolidation will be liable to VAT and WHT just like it is applicable on the emergence of a new company. Stamp duties will be paid on the increase in share capital and the company will have to obtain its own staff pension scheme approval from the joint Tax Board (JTB).

Ceased Businesses

The merger or consolidation exercise may also result in cessation of business for any of the merging parties. In this case, cessation rule as applicable under section 29(4) of CITA will apply to any of the merging companies which have now ceased business permanently, except if any of the following circumstances occur:

(i) Where the merging companies are connected. Here, the Board may direct, in line with its discretionary powers, under section 29(9) of CITA that the cessation rule may not apply.

(ii) (ii) Where a reconstituted company is formed to take over the trade or business formerly run by its foreign parent company. (See Section 29(10) of CITA.

a. Trade or business sold or transferred: Section 25(9)

If a trade or business is sold or transferred to a Nigerian company together with any asset employed therein and the Board is satisfied that one of the companies has control over the other or that both are controlled by some other person or are members of a recognized group of companies, the Board may in its discretion direct that:

- the commencement and cessation provisions are not applied;
- for capital allowances purposes, the assets sold or transferred shall be deemed to have been sold for an amount equal to the residue of qualifying expenditure thereon on the day following such sale or transfer; and
- the company acquiring the assets shall not be entitled to any initial allowance thereon and shall be deemed to have received all allowance already granted to the vendor company up to the date of the sale or transfer.

There is no reference to unutilized losses incurred in the old trade. Thus, such losses cannot be transferred to the new business and may not be relieved in any other way. Any company planning a reorganization that will involve transfer of business from one subsidiary to the other within the group will need to consider this fact that is the unabsorbed losses on the date of the transfer or sale of the business cannot be transferred to the new business. A way out is to leave some business in the old trade that will produce small profits annually which will gradually use up the losses over a number of years before that part of the trade is transferred to the new trade.

b. Reconstituted Companies: Section 25(10)

Where in pursuance of Part X of the Companies and Allied Matters Act, (1990), a company- "the reconstituted company" - is incorporated to carry on a trade or business previously carried on by a foreign company and the assets employed by the foreign company in that trade or business vest in the reconstituted company, then the following provisions shall apply:

- the commencement and cessation provisions shall not apply to the reconstituted company;
- the assets vested in the reconstituted company shall be deemed to have been sold to it, on the day of incorporation of that company, for an amount equal to the residue of qualifying expenditure thereon on the day following the cessation of the foreign company's trade;
- c) the reconstituted company shall not be entitled to any initial allowance on those assets and shall be deemed to have received all capital allowance granted the foreign company on those assets;
- Unrelieved losses of the foreign company on the date of the reconstitution shall be deemed to have been incurred by the reconstituted company in its trade or business during the first year of assessment and shall be deductible from its assessable profits. Losses arising from damages caused by the Nigerian Civil War cannot be so transferred to the reconstituted company except with the approval of the Federal Executive Council. it is also to be noted that a claim for the deduction of such losses must be lodged with the Director of the industrial inspectorate Division of the Federal Ministry of industries with a copy to the Board within three years of the incorporation of the reconstituted company;
- Deduction of such losses is to be made from the assessable profits, if any, of the reconstituted company for the first year of assessment and so far as it cannot be so made, then from the amount of the assessable profits of the year of assessment and so on up to the fourth year after the commencement of such business.

The foregoing will only be applicable if the Board is satisfied that the trade or business carried on by the reconstituted company immediately after its incorporation is not substantially different in nature from that previously carried on in Nigeria by the foreign company.

Capital Gains Tax on Shares or Cash Received

Section 32A of Capital Gains Tax Act (CGTA) Cap 121LFN 2004 provides that a person shall not be chargeable to tax under the Act, in respect of any gains arising from the acquisition of the shares of a company, either merged with, or taken over or absorbed by another company, as a result of which the acquired company has lose its identity. However, where shareholders are either wholly or partly paid in cash for surrendering their shares in the ceased business, the gains arising from the cash payment will be subject to CGT.

Effect of Taxations on Consolidation Acquiring/Acquired Companies

The tax implications of consolidation on acquiring company or acquired companies are similar to those of mergers. Acquisition expenses are non-deductible while fees paid to professional bodies are equally to WHT and VAT.

12.06 Review Questions

1. Distinguish clearly with good examples between takeover, merger, and business combination.

2. Explain the reason for merger and acquisition in accordance with shareholders gain and managerial gains.

3. Explain tax treatment of consideration paid in merger and acquisition.

4. What are the tax implications of ceased and surviving business under merger and acquisition.

5. Describe the statutory requirement under Companies Income Tax Act (CITA) for merger and acquisition.

6. ACN Ltd and CPC Ltd merged on January 2012 to form APC Ltd. The trading results of the companies as adjusted for income tax purposes were as follows

	ACN Ltd		
Year to 31 Dec	2009	Profit	350,000
Year to 31 Dec	2010	Profit	190,000
Year to 31 Dec	2011	Profit	250,000
CPC Ltd			
Year to 31 Dec	2009	Profit	250,000
Year to 31 Dec	2010	Profit	274,000
Year to 31 Dec	2011	Profit	230,000

APC Ltd

Year to 31 Dec	2012	Profit	424,000
Year to 31 Dec	2013	Profit	480,000

You are required to:

a) State the bases of assessment of APC Ltd

b) Compute the assessable profit of ACN Ltd, CPC Ltd and APC Ltd for the relevant years of assessments.

MODULE 13

13.00 TAX AUDIT AND INVESTIGATION

13.01 Learning outcome

On successful completion of this Module, Students should be able:

i. Examine the process of reviewing tax payer's files and returns;
ii. Appraise various types of audit exercises;
iii. Evaluate the concept of Tax investigation and its stages;
iv. Assess the criminal investigation and intelligence unit.

13.02 Introduction

Prior to the introduction of self-assessment, there was no specific provision for tax audit and investigation under company income tax Act. This was later introduced to assist in verifying the tax return filed by tax payers through adequate tax audit process.

13.03 Tax Audit and Investigation

Prior to the introduction of self-assessment, there was no specific provision for tax audit and investigation under company income tax Act. This was later introduced to assist in verifying the tax return filed by tax payers through adequate tax audit process.

13.04 Definition of Tax Audit

An audit is an examination usually by an independent person, on a set of the accounting books, records, documents, etc., from which a set of financial statement has been prepared.

Objectives of Statutory Audit

The objectives of an audit are to express an opinion as to whether:

a) Proper books have been kept;

b) The financial statements are in agreement with the books;

c) The requirements of the applicable legislations, for example, CAMA, 1990 (as amended) have been complied with;

d) Applicable Accounting Standards (both local and international) have been adhered to;

e) The financial statements give a true and fair view of the state of the financial affairs of the enterprise as at its balance sheet date; and

f) The financial statements give a true and fair view of the result of the operations of the enterprise for the period under audit.

Specialized Audits

Specialized audits are normally involved whenever special attention is needed on special issues that are not part of the objectives of statutory audits. When a specialized audit is carried out, the auditor would cover in his report the particular objectives that were to be achieved as set out in the auditor's terms of reference.

Tax Audits

Tax audits similar to special audits. They are additional to statutory audits and are carried out by tax officials from relevant tax authority (ies). The approach and scope of work would be slightly different from that to be carried out for audit under CAMA, 1990.

Power of the Revenue Service to Audit

Prior to the introduction of the self-assessment scheme, there was no specific provision in CITA for tax audit. Subsection 4 of Section 43 was introduced to empower the Inland Revenue to carry out tax audit. The subsection states: Nothing in the fore going provisions of this Section or in any other provisions of the Act shall be construed as precluding the Revenue Service from verifying by tax audit any matter relating to entries in any books, documents, accounts or returns as the Revenue Service may from time to time specify in any guideline.

An integral part of the self-assessment scheme is the need to periodically verify the tax return filed by taxpayers through a tax audit process. The tax audit exercise essentially is meant to enable the Revenue authority to further satisfy itself that audited financial statements and the related tax computations submitted by the taxpayer agree with the underlying records. This periodic check is carried out by the tax audit branch.

13.05 Objectives of Tax Audit

The objectives are to enable the tax auditors determine whether or not:

(a) Adequate accounting books and records exist for the purpose of determine the taxable profits or loss of the taxpayer and consequently the tax payable;

(b) The tax computations submitted to the tax authority by the taxpayer agree with the underlying records; and

(c) All applicable tax legislations have been complied with.

Other objectives of tax audit are:

(a) Provision of an avenue to educate taxpayers on various provisions of the tax law;

(b) Discourage tax evasion;

(c) Detect and correct accounting and/or arithmetical errors in tax returns;

(d) Provide feedback to the management on various provisions of the law and recommend possible changes;

(e) Identify cases involving tax fraud and recommend them for investigation;

(f) Forestall taxable persons' failure to render tax returns;

(g) Forestall taxable persons' rendering incomplete or inaccurate returns in support of the self-assessment scheme.

Tax audit is usually conducted by a group of experienced support staff of the Revenue authority.

The Tax Audit Branch

In the past, that is, before the current reform exercise at the FIRS, the Tax Audit Branch was under the directorate of Assessment, Intelligence, Tax Audit and Special Investigation and reports to the management through the Director. However, with their form, each of the Integrated Tax Offices (ITO'S), is expected to have its own resident Tax Audit Unit.

Types of Tax Audit

The two types of tax audit are:

(a) Desk Audit; and

(b) Field Audit.

a. Desk Audit

As soon as a tax return is received in the Inland Revenue's office, such would be subjected to examination by the Inspector. This examination is carried out in the tax office. It is carried out on routine basis, indicating that most, if not all, returns submitted to the tax office, are subject to this audit.

The focus of the desk audit would be to ensure completeness of the items submitted for tax purposes. The Inspector earring out a desk audit will also look for apparent errors or mistakes in the tax computations and/or in the accompanying documents and records. The outcome of a desk audit may lead to the conduct of a field whenever additional information or documentary evidence is required to satisfy the Inspector of Taxes carrying out the desk audit.

b. Field Audit

A field audit is more elaborate and comprehensive than a desk audit. It is usually carried out outside the Inland Revenue's office, in the taxpayer's business premises. The need to carry it out in the taxpayer's premises is to enable the tax auditors carry out the examination of applicable documents and also obtain appropriate information directly from the officials of the business.

The Tax Audit Process Pre Assessment Stage

The tax audit branch carries out audit exercise only on companies that have been referred to it by the management. The ultimate authority for referral of cases for audit lies with the Chairman through the Director of Assessment. The usual channels for recommending cases for audit include:

(a) The Management: The technical committee, the chairman and the directors could refer cases directly to the branch.

(b) **Zonal Coordinator:** The Zonal coordinator may also recommend cases for tax audit through the Director of assessment

(c) **Tax Controller:** Desk officers through their tax controllers (TC), recommend cases for tax audit. The TC would then pass such recommendations to the Director of assessment.

(d) **Tax Audit Inspectors:** Sometimes, in the course of the audit of a company, it might become imperative to conduct composite audit that is widening the tax audit exercise of a company to cover others within the same group or those with substantial transactions with the company undergoing audit. In such instances, the tax auditor may recommend that ongoing audit be extended to cover related companies.

Assessment Stage

The stages in the audit process are as follows:

(a) Selection of taxpayer to be audited;

(b) Preliminary review of taxpayer's file;

(c) Notification of Taxpayer;

(d) Pre-audit meeting followed immediately by field audit;

(e) Post audit meeting;

(f) Interim Audit Report;

(g) Post audit review by Regional/Headquarters Audit;

(h) Reconciliation meetings; and

(i) Final Audit Report.

Selection of Taxpayer to be Audited

The guidelines and criteria for selection of files for audit are to be determined by the Audit Headquarters. The selection of cases for audit is a management function. The criteria which would vary from one type of business to the other include, but are not limited to, the following:

(a) Self-assessment taxpayers- at least two years since that last audit of the taxpayer.

(b) Taxpayer s with refund claims-especially arising from excess withholding tax credits and, or other named reasons.

(c) Taxpayers with nil returns or continuous loss situation.

(d) Taxpayers with very low adequacy ratios.

(e) Based on routine industry checks or sectorial audit (project audit).

(f) Based on lead information received from Intelligence or other FIRS departments or external sources.

(g) Transfer pricing arrangements.

(h) Tax planning schemes.

(i) Claims under Double Taxation Agreement (DTA)

(j) Secondary files-relationship with another taxpayer by way of holding, subsidiary, associated or related companies, could be criteria for selecting companies for audit.

(k) Industrial group's compliance evaluation and profitability comparison.

(l) Verification of poor or extraordinary performance.

(m) Referrals resulting from desk examinations.

(n) Information resulting from examination, audit and investigation of other taxpayers.

(o) Random sampling.

(p) Firms making unusual requests or taking extraordinary decisions such as centralizing an erstwhile decentralized operation.

(q) Information from intelligence unit of the tax authority.

(r) Directive from higher government authority.

Preliminary Review of Taxpayer's File

This is aimed at preparing both the Audit Department and the audit team that will be involved in the audit exercise for the audit task ahead it involves obtaining basic information about that taxpayer, analytical review of taxpayer's performances using ratio analysis highlighting risk for the taxpayer.

This review will also lead to the determinations of the appropriation tax audit strategies to be adopted, which include, recommendation on the audit approach, number of days/weeks required, level of experience and technical skills required, number and location of offices to be assembled for the field audit exercise. This procedure will be reviewed and approved by the Regional/Headquarters Audit, as appropriate.

Preliminary Activities

Before audit executives set out, certain preliminary activities must take place. These are:

(a) Gathering of the files and groping them into the number of audit teams to be established;

(b) Audit teams to acquaint themselves with background information about their cases;

(c) Prepare audit checklist to be used in respect of each company to ensure that all necessary areas of audit activities are covered;

(d) Design interview format (if necessary) for each company, depending on the problems, so as to ensure that all grounds are covered;

(e) Assign specific duties to audit team members.

Audit Checklist

The complexities of some business and/or the need for comprehensiveness make the preparation of audit checklist necessary at the planning stage of a tax audit. The checklist is used during the audit exercise to ensure that a thorough job is done. It also ensures that the exercise is undertaken systematically and not in a haphazard manner. Thus, it makes the audit work to be faster, orderly and properly completed. The activity items listed in the checklist are ticked off as performed one after the other as the work progresses, until the audit is completed.

Background Information

The following are basic information to be extracted from the taxpayer's file:

(a) Name of the company;

(b) Registered address;

(c) Business address;

(d) Date of incorporation;

(e) Date of commencement of business;

(f) Tax file number;

(g) Nature of business;

(h) External auditors/ tax consultants and their addresses;

(i) Bankers/addresses:

(j) Solicitors and secretaries;

(k) Share capital (authorized and issued);

(l) Shareholding structure;

(m) Names of directors/number of shares held;

(n) Associated companies/addresses;

(o) Litigation details, if any;

(p) Period covered during the last audit or investigation exercise; and

(q) Accounting year end.

Analytical Review of Tax Returns: The officer-in-charge will use the following records to determine the taxpayer's performances and areas of tax audit focus:

(a) Last audit or investigation report (if any)

(b) Financial Statements:

i. Chairman/Directors/Auditors' reports;

ii. Balance Sheet and Profit and Loss Accounts;

iii. Cash flow Statements; and

iv. Notes to the Accounts.

(c) Tax Returns

From the above, a spreadsheet of Balance Sheet, Profit and Loss Accounts and Notes to the Accounts of the years to be covered is prepared.

Ratios: The relevant ratios, out of the followings, would be computed and interpreted:
(a) Liquidity/Solvency

These are ratios designed to measure taxpayer's ability to meet his obligations.

i) Current (or working capital] Ratio

ii) Acid Test (or Quick) Ratio

iii) Working Capital Turnover

iv) Assets Turnover

(b) Efficiency (Activity)

These are ratios that measure effectiveness of taxpayer in using his assets.

i) Account Receivable to Turnover Ratio

ii) Age of Accounts receivable

iii) Investor Turnover

iv) Working Capital Turnover

v) Asset Turnover

(c) Equity Position and Coverage

These are ratios that measure that balance between the resources provided by the creditors and owners of the company.

i) Debt Equity Ratio

ii) Debt to Total Assets Ratio

iii) Book Value per ordinary share

(d) **Profitability**

These are ratios that measure the ability of the taxpayer to generate an excess over turnover.

i) Profit Margins on sales

ii) Return on Investment

*	Return on Total Assets

*	Return Oil Owners equity

iii)	Ratio of Tax already lessened to Net Profits

iv)	Ratio of Cost of Sales to Turnover

The tax auditor should bear the following tax evasion tendencies in mind;

(a)	Understatement of income.

(b)	Overstatement of expenses.

(c)	Undervaluation of stocks.

(d)	Creation and maintenance of secret reserves.

(e)	Postdating sales (what happens to the related costs when income is postdated).

(f)	Omission of income.

Proper interpretation of these ratios will lead to determination of the risk areas for tax audit focus.

Notification of Taxpayer: On completion and approval of the preliminary review by the Head of the unit, the taxpayer or his tax consultants will be notified of the field audit, which will then be carried out in the company's premises.

The notification letter will state the following:

(a)	Period (years) that the audit exercise will cover

(b)	List of records/documents to be made available for the audit.

The company should be notified that this list is not exhaustive.

(c)	Date and time of commencement of audit exercise.

(d)	Names of the Inland Revenue officials that will carry out the audit.

Members of the audit team are expected to carry their identify cards. The identify cards should neither be taken away from the auditors nor allowed to be photocopied.

Pre-Audit Meeting followed by Field Audit:

(a) The field audit exercise must commence with a preliminary meeting with the management of the company usually represented by the Managing Director and/or Financial Director or their representatives.

The Company's Tax Consultants where necessary are also expected to be in attendance at this meeting.

(b) The meeting is aimed at:

(i) Informing the taxpayer of the purpose of the audit.

(ii) Confirming background information of the taxpayer earlier obtained in the assessment file.

(iii) Getting other relevant information that are not available in the file.

(iv) Familiarizations with the company's accounting and operational systems which include, but not limited to, the following:

* Whether the company operates manual or computerized accounting system.
* Whether the accounting system is on cash or accrual basis.
* The invoicing system in place for sales and purchases.
* Whether all cash received are banked intact before expending there from.

(v) Giving the taxpayers the opportunity to express their views on the audit.

(vi) Seeking the cooperation of the taxpayer in terms of providing books and records and explanation where necessary.

(c) The team leader is expected to chair the meeting while a member of the audit team is expected to take minutes of the meeting.

(d) Part of the functions of the team leader is to approve the draft of the minutes ensure that the final copy is produced and signed on the field by the officer that prepared it, the team leader and the company's representative, as well as the tax consultant where necessary. A copy of the signed minutes must be given to the representatives of parties concerned.

Post Audit Meeting:

A post audit meeting should be held immediately after the end of the field audit, between the tax auditors and the taxpayers and their representatives at the taxpayer's premises the purpose of this meeting is to obtain any further outstanding information/document that may be available only from the taxpayer's management and to answer outstanding questions that arose during the field audit work.

Minutes of the meeting should be documented in writing, signed by both parties and a copy given to both parties. This marks the end of the field audit and departure from the taxpayer's premises.

Audit Reports:

Preliminary Report: Sometimes, the scheduled officer of a case would come across material issues, in the course of the preliminary review of the assessment file that should be brought to the notice of the management. In such an instance, a preliminary report would be prepared and sent to the chairman detailing such issues.

Interim Report: After the field audit, exercise, progress reports could be called for by management. The team leader should collate the individual reports of all the team members and write the Interim Audit Report. The report should highlight details of all the findings that may result in additional tax assessment as well as areas of possible dispute with the taxpayer and suggestions on how to resolve them.

The report should be addressed to and reach Regional audit or Headquarters as appropriate within one week of the post audit meeting.

Post Audit Review by Regional/Headquarters Audit: The Regional/Headquarters Audit will review the Interim Audit Report as soon as it is received, by giving clear directives on all reported matters, after due consideration of the technical issues involved based on the prevailing tax laws, as well as the generally accepted accounting principles. This will form the basis for the reconciliation meetings.

Reconciliation Meetings:

This is a meeting between the tax auditors (with representatives of Regional/Headquarters Audit present as appropriate) on the one hand and the taxpayers (and their representatives and tax consultants) on the other hand. The purpose of the meeting is to resolve all outstanding issues arising from the field tax audit exercise with a view to determining the additional tax due and resolving all disputes in accordance with the tax laws of Nigeria.

After the reconciliation meeting, additional assessment may be issued as appropriate with notices, while outstanding matters treated to a logical conclusion.

However, in the case of any formal objection by the taxpayer, the reasons for the objection will be considered and notice of amended assessments or notice of refusal to amend the assessment will be issued as appropriate.

Objections by the tax payer to the additional assessment should be made within reasonable time, otherwise the additional assessment become final and conclusive. Where notice of refusal to amend is issued, the tax auditor should ensure that due process is strictly adhered to in documentation, record keeping and correspondences as these may affect the success of FIRS' defense against any appeal filed by the taxpayer before the Body of Appeal Commissioners.

It should be noted that all further appeals lie with the High Courts, Court of Appeal and Supreme Court. All that transpired at the reconciliation meeting should be documented in form of minutes, which will be signed and distributed to all parties.

Final Audit Report: The audit report is very important and should be rendered immediately an audit is completed. It contains all important items about the company and the audit work done.

Audit reports tend to expose system's weaknesses and shoddy audit job is also easily revealed. The reports will state the findings and details of tax liabilities, if any. An audit report should always be completed with the auditors' recommendation. Such recommendations may include the need for extended audit, special investigation and even prosecution.

Based on the minutes and outcome of the reconciliation meetings, the final audit report will be written by the Audit team leader. The report which should be addressed to the Regional/Headquarters Audit, will state in detail, the additional assessments agreed at the reconciliation meeting as well as those disputed.

The additional assessments agreed should be separated from those disputed. Both should be analyzed in tabular form under various taxes (eIT, WHT, CGT, VAT,PAYE etc.) for each year of assessment concerned. The report should indicate details of how each additional assessment was arrived at. The Regional/Headquarters audit will consider the report within a reasonable time of its receipt and issue clear directives for issuance of notices of additional assessments, amended assessments and notice of refusal to amend assessment, as appropriate. The report will also form the basis of FIRS defense in case of an appeal to the Body of Appeal

Commissioners, in which case, a copy of the report will be sent to the Legal Adviser for follow-up.

13.06 Types of Audit Exercise:

(a) Routine Sector Audit

This audit covers companies operating within a specific industry, for example, banking, construction, Oil servicing, shipping. The objective is primarily to ascertain and assess the overall compliance level in particular industry.

(b) Routine Zonal Audit

The tax audit branch is located within the Lagos zone and thus operates more actively within the zone. However, periodic audit tours of other zones are carried out. Companies within such zones irrespective of industry are visited and audited. The new dispensation makes the audit unit reside in the Tax Office that has jurisdiction over the taxpayer's file.

(c) Special Purpose Audit

Apart from routine audits, sometimes management would direct the branch to carryout audit to achieve a specified purpose. Such instances include:

(i) Verification of taxpayer's claims for tax refunds;

(ii) Dispute between taxpayers and the Area Office on specific issues;

(iii) Suspected cases of tax evasion;

(iv) Value Added Tax audit; and

(v) Management's directives.

Technical Procedures

Technical procedures refer to the process of earring out tax audit. It involves planning, organizing and executing all activities required to effectively carry out the audit. The process could be grouped as follows:

(a) Allocation of Audit Cases: All referred cases 'must be allocated to individual inspectors who would be the schedule officer for each case. The criteria for allocating cases are mainly the level of competence of an inspector considering the urgency attached to the audit, the technically involved, size of the company and other relevant factors.

(b) Pre-Audit Visit Activities: The schedule officers' first task would be to obtain the company's assessment file (and sometimes, the collection file) from the Area Office for the purpose of extracting relevant financial data. After the extractions, a comprehensive file review would be done and a report written. The report will show the background information of the company, the tax history, relevant performance ratios, and comments on tax queries raised by the Area Office, areas of potential audit risks and recommendation as to outcome of the audit.

(c) Circularization letters: These may be set to identify third parties for independent confirmation of certain information.

(d) The Field Audit: An audit team comprising Inspectors and a team leader would visit the company to carry out the field examination of the company’s records. The duration of the field work depends on the volume and complexity of the company's it operations.

(e) Reconciliation Process: After the field audit, the summary of the audit findings would be sent to the company and its tax consultants for their reaction and a date is then fixed for reconciliation. The reconciliation involving the review of additional, written representations, interviews and meetings would then begin until after all contentious issues have been resolved. Thereafter, a final letter of intent detailing the Revenue's position on the unresolved issues and computation of any additional tax would be sent to the taxpayer.

(f) Assessment: The relevant notices of additional/revised assessment are raised after the letter of intent has been sent. Also, the withholding tax Section would be advised to pursue collection of any withholding tax that may become due as a result of the exercise.

(g) Objectives: Objections to the additional assessment could be raised either immediately after the letter of intent has been received by the taxpayer or after notices of additional assessment have been raised. In either case, a review of the working papers or whole file would be initiated with a view to ascertaining the validity of the company's objection. Sometimes a revisit would be made to the company to verify any new documents available. Having confirmed that the position adopted by the Tax Audit is right, notices of refusal to amend the assessments would be raised after obtaining the headquarters' authority to do so. The case could then be referred to the legal Section for litigation.

(h) The final Report: Once all objections, it any, have been disposed of, a final report of the tax audit exercise would be made to the management. The major elements of the report would include: the background information of the company, the pre-and post, audit tax adequacy ratio, the audit work performed, major audit findings, tax yield, recommendations and conclusions

13.07 Audit Programme

This is a schedule of audit work expected to be performed on each item of the accounts such as income/turnover, expenditures, assets and liabilities.

Benefits of the Audit Programme

The audit programme would be useful in the following areas:

(a) It will provide details of the work, which the team leader requires individual members of the team to perform.

(b) It will provide information as to how much of the audit work has been completed as at a particular date, and how much is outstanding.

(c) Provides a record of audit responsibility by providing a record of the audit members responsible for each part of the completed work.

(d) Facilitates audit supervision and control, giving senior members of the audit team information and knowledge regarding the progress of the work done to date.

(e) Ensure continuity in the audit work, should there be a change in the personnel constituting the audit team, with new members being able to see at a glance the outstanding work to date, thus providing a basis for planning and staffing the audit team.

(f) Provides an avenue for the team leader to allocate his available staff in the most productive and efficient manner possible.

(g) It is a time management tool.

The thrust of a tax audit will be that of verification of the figures and other information submitted by the taxpayer for tax purposes.

The primary purpose of tax audit has been expanded to monitor and maintain the confidence in the integrity of the newly introduced self-assessment system. It helps to improve voluntary compliance by detecting and brining into account those who do not pay the correct amount of tax.

Tax audit is a routine exercise and the outcome usually leads to reassessment or referral for special investigation if tax evasion is suspected.

13.08 Tax Investigations

Investigations, as distinct from tax audits, are called for when there are problems in, for example, an organization either affecting the whole or particular segment of the organization. Such could be required when a large fraud is suspected or when evidence of mismanagement abounds and an interested party requires that the effect on the enterprise be quantified for management decision-making purpose.

In an investigation, the scope of work is wider than that of a tax audit. The details of checking and depth of the work will also likely be more than that required for an audit exercise.

Tax investigation, is similar to any other form of investigation. It is not carried out on routine basis as that of an audit. For example, a statutory audit of the accounts of a company must be carried out every year, whereas investigation may not be carried out in the same company for several years.

Tax investigation would be carried out when a taxpayer is suspected to have committed fraud. Suspected cases of tax evasion could lead to investigation. These could be due to: failure to file tax returns; filing of incomplete or inaccurate returns; failure to register for tax purposes etc.

Special Investigation results from suspicion or actual knowledge of the existence of tax evasion or tax fraud. It is conducted by tax inspectors who have special training and competence in investigation techniques. They can request for assistance of police investigators and enforces, if necessary.

The principal aim of investigation is to expose all the circumstances of the fraud or tax evasion and to obtain evidence for possible prosecution. Tax investigators have been given greater power than tax auditors. They can seal up J business premises to facilitate their work and obtain all the documents needed to substantiate the evidence of tax evasion and fraud.

Stages of Tax Investigation

Actual investigation of tax cases involves the following stages:

(a) **Surveillance or Pre-Investigation Activities:** This involves checking and cross checking, obtaining more information on the alleged tax fraud. It involves discrete analysis of data, reports and complaints. These have to be done speedily or the offence could become compounded.

(b) **Evidential Audit or Investigation:** At this stage, the investigators move into the business premises of the suspected party to conduct in-depth tax audit, take charge of any evidence discovered, secure a warrant of arrest ad have the suspect arrested if necessary. At this stage, any individual may be invited for investigation. Also, thorough searchers of individuals, offices and apartments may be conducted to obtain relevant evidence that might be useful in prosecuting the case.

(c) **Case Preparation:** This involves the collation of evidence, the interrogation of suspects, and careful examination and analysis of seized documents to assess their relevance to the case and potency in the law courts. At this stage, the case can still be dropped if the evidence is weak.

(d) **Arraignment:** This is the stage where the case goes to court for criminal prosecution. All the evidence collected and witnesses secured are made available to the prosecutor who is thoroughly briefed on the case.

(e) **Termination of Investigation:** Investigation in a case of criminal tax fraud or tax evasion can be terminated at any stage, if the following conditions obtain:

(i) Insufficient evidence.

(ii) Criminality is not involved; may be what happened was tax avoidance and not tax evasion or fraud.

(iii) There can be termination by law where continuation can no longer be sustained under the provisions of the law. An example is where such a case becomes statute-barred.

(iv) If the suspect dies or becomes medically or legally in same.

Functions of Investigation/Intelligence

The Investigation/Intelligence Unit of the Federal Inland Revenue Service is in charge of all investigations and intelligence activities of Inland Revenue.

The roles and responsibilities of the Head of the Division are as follows:

(a) Articulate and direct policies and programmes aimed at achieving the objectives of the division;

(b) Define key operating/guiding principles;

(c) Design strategies for deterring violations of tax laws and hence ensuring tax compliance;

(d) Set up procedures for case referrals from Tax Offices;

(e) Set lip proactive processes and define parameters for identifying potential cases of violations;

(f) Address emerging areas of fraud for example, e-commerce, fraudulent financial reporting;

(g) Collate and maintain reliable statistics of investigations/intelligence work;

(h) Coordinate the activities of all the units in the division;

(i) Allege purchase of foreign assets at inflated amounts, which results in excess capital allowances claim.

(i) The use of tax havens and its detrimental impact on the tax system could be significant, both in terms-of revenue and compliance.

(vii) Income splitting arrangements.

(b) Investigate cases for tax refunds

(c) Review cases for mergers and acquisitions.

(d) Issue warrants for search and seizure under Section 45A.

(e) Refer cases to criminal investigations unit where there are indications of deliberate intention to evade tax or commit fraud etc.

(f) Identify areas for amendments to tax laws in order to plug all areas of tax leakages.

13.09 Responsibilities of Criminal Investigation Unit

The criminal investigation unit is responsible to:

(a) Investigate, penalize and recommend prosecution in cases of tax evasion. With tax evasion, you have fraud with “menswear”, the amounts are clearly taxable (suppression of income, fictitious expenses) and does not require an amendment to the tax law. Evasion transactions are done knowing that it was unlawful to do. Normally criminal charges are laid which could result in fines and/or a jail term in addition to the tax and penalties. Examples are:

(i) Arrangements premeditated to reduce tax payable;

(ii) Understatement or non-disclosure of income;

(iii) Overstatement of expenses;

(iv) Creation of fictitious assets and expenses;

(v) Disproportionate share of expenses and income between offshore and onshore entities;

(vi) Complex management structure and associated entities that would result in tax evasion;

(vii) Non filing of tax returns or filing of incorrect returns; and

(viii) Denial of Federal Inland Revenue Service access to records.

(b) Investigate and liaise with relevant agencies for prosecution in cases of:

(i) Fraudulent diversion of Federal Inland Revenue Service taxes such as Withholding tax, Value Added Tax, etc.;

(ii) Fraudulent payment of income tax and other taxes through use of falsified withholding tax receipts;

(iii) Abuses by companies and Government agencies in Value Added Tax/Withholding Tax deduction and remittance; and

(iv) Fraudulent procurement of Tax Clearance Certificate, revenue receipts, Withholding Tax Credit notes.

(c) Carry out search and seizure where such would result in obtaining relevant document for an investigation.

(d) Analyze and evaluate evidences obtained to establish criminal violation, follow up with assessment, penalties and prepare case for prosecution.

(e) Identify the areas for amendments to tax laws in order to plug all tax leakages.

(f) Assist in preparing evidence for prosecution of violators.

(g) Liaise with the National Drug Law Enforcement Agency (NDLEA),Economic and Financial Crimes Commission (EFCC), Nigeria Deposit Insurance Corporation(NDIC) and Central Bank of Nigeria (CBN) to investigate violation of tax laws in cases of white-collar crimes such as money laundering.

Intelligence Unit

The main function of this unit will be to gather and analyses information and thus maintain a database of information for civil/criminal investigation and the Federal Inland Revenue Service in general. Specifically, the unit will:

(a) Liaise with Tax Offices to obtain information on returns filed, Stop-taxpayers, late tax payers, etc. for database;

(b) Liaise, on a regular basis, with banks and the Corporate Affairs Commission to obtain information on new accounts (Section 44), new companies, that is, non-filers;

(c) Liaise with Ministries/Government parastatals on contracts for current and prior years, for cross-checking the returns filed by the companies.

(d) Gather and review information in newspapers, magazines, journals, radio and television for signs of potential civil or criminal violations:

(e) Use intelligence techniques (for example, surveillance techniques and computer database searches) to gather information on a company's businesses, financial activities, etc.

(f) Carry out special enforcement programs on suspected targets:

(g) General intelligence collection;

(h) Refer cases to the civil or criminal investigation unit after carrying out relevant analysis;

(i) Obtain information from third parties; and

(j) Obtain and review published financial statements of offshore companies,

Assessment of Investigation/Intelligence Division

(a) Strengths

(i) To management support:

(ii) Quality staffing with Inspectors of high integrity and professional, competence preferably chartered accountants, economists and lawyers;

(iii) Enforcement powers in the tax laws such as power to seal up company premises, to issue warrants after due consultation with the management in the case of resistance; and

(iv) FIRS legal unit's continued assistance in the prosecution of tax offenders and advising on legal issues,

(b) Weaknesses

(i) Internal and external interference

(ii) Obstruction of investigation through abuse of the judicial process,

(iii) Conf1icts between Tax Audit Section in Tax offices and civil provision of necessary documents and records,

(iv) Inadequate funding due to budgetary constraints,

(v) Inadequate experience in criminal investigation,

(vi) Reliance on external bodies such as the Nigeria Police, Economic and Financial Crimes Commission, etc.

(vii) Inadequate infrastructure-Computers and Equipment to perform necessary duties and unstable power supply.

13.10 Review Questions

a. Comment on the Objectives of Tax Audit

b. '*The tax audit branch carries out audit exercise only on companies that have been referred to it by the management'*. Discuss the usual channels for recommending cases for audit include

c. Identify the differences and similarities between the different types of audit exercise:

d. What are Benefits of the Audit Programme?

MODULE 14

14.00 TAX PRACTICE

14.01 Learning outcome

On successful completion of this Module, Students should be able:

i. Examine the meaning and procedures for tax audit and investigations;
ii. Evaluate the fundamentals of clients documentation and records;
iii. Develop the strategies for communication and registration with tax authorities;
iv. Prepare self-assessment for individuals;
v. Disintegrate between tax avoidance and tax evasion.

14.02 Tax Audit and Investigations

The entire process of tax practice involves matters relating to appointment and acceptance of offer by the tax consultant to act as a tax consultant.

Activities to be conducted to achieve the Designed Outcomes

Practical demonstration by a practicing certified member should be carried out, ethical issues need to be stressed for proper adherence.

Communication with Clients

There is always the need for timely communication with Clients on matters relating to appointment and acceptance of offer to act as Tax Consultant, as well as updates on representation to the Tax Authorities. Tax Payers are of two categories:

(a) Individual Tax Payers, and

(b) Corporate Tax Payers

Individual Tax Payers file tax returns to State Internal Revenue Service, while Corporate Tax Payers (usually Companies) file returns with the Federal Inland Revenue Service.

It is, therefore that when appointing Tax Consultants, Clients must specify the scope of assignment in the Letter of Engagement. The Tax Consultants must also be guided in accepting any job and understand their obligations as Tax Agents, Liaising between the Clients, Tax Authorities and other third parties.

Appointment of Tax Consultant

Appointment of Tax Consultant is usually communicated vide Letter of engagement emanating from the Tax Payer to the Tax Consultant.

A typical Letter of Appointment is shown below:

Illustration I

Letter of Appointment as Tax Consultant written

On the letterhead of CNA NIGERIA LTD

25thAugust, 2014.

The Managing Partner

Crest Consult

20 Gyangoad

Bokkos, Jos

Dear Sir,

Appointment as Tax Consultants

We refer to the discussion held recently with our Directors on Tax and related matters and hereby confirm that management has today approved your firm's appointment Tax Consultants to our company with immediate effect.

Please note that the services to be rendered include Employees Directors and Company Tax matters.

You are to please liaise with our Financial Controller, who will provide you with all necessary information and financial statements/records which you might require in the course of carrying out the assignment.

We propose a meeting with you for next Wednesday August 30, 2014 by 2 pm at out head office to finalize the details.

We look forward to mutually beneficial relationship between our company and your organisation.

Thank you.

Yours faithfully,

For: CNA NIGERIA LTD

(Signed)

(MANAGING DIRECTOR)

Cc: The Tax Controller

Federal Inland Revenue Service

Integrated Tax Office, Jos.

Acceptance of Offer as Tax Consultant

The Acceptance of offer as Tax Consultant to a Tax Payer is the indication of the readiness 'of the Tax Consultant to render the specific services requested and to provide other special assignments to the Client(s) from time to time.

The Consultant from inception should understand the nature and scope of the assignment in order to provide adequate services to the Client(s) issues relating to Professional Fees should be fully discussed at the inception of the contract of service.

Solution

5th May, 2009.

The Managing Director

CNA Nigeria Limited

4, Miango Way

Kwall, Jos.

Dear Sir,

Acceptance of Offer as Tax Consultants

Your letter of 25th August, 2014 on the above subject matter refers.

We confirm our firm's acceptance of your offer to act as Tax Consultants to your organisation.

From the contents of your offer letter, we understand that we shall provide tax related and advisory services to your company, its Directors as well as Employees. We will also only represent your interest with the relevant Tax Authorities from time to time.

We shall be pleased to meet with you as scheduled.

Yours faithfully,

(Signed)

Managing Consultant

For: CNA Consult

14.03 Clients Documentation and Records

After accepting the offer to act as Tax Consultant to any Taxpayer, necessary documentation and information, should be put in place.

Documentation/and information to be maintained/provided by Clients.

The company's (client's) officers should have maintained the following document/records.

(a) Certificate of Incorporation

(b) Certified True Copies (CTC) of Memorandum and Articles of Association (MEMAT).

(c) CTC of Forms on Directors (CAC 7), Allotment of Shares (CAC 2),Appointment of Secretary /CAC 2.1) and Notice of Registered office (CAC 3).

(d) Certificate of Increase in Share Capital including Stamp Duties, Registration etc.

(e) Contracts, Rents and other Agreements.

(f) Financial matters

(i) Signed Audited Financial Statements.

(ii) Books of Account, Ledgers, Trial Balance (Hard &Soft copies)

(iii) Fixed Assets Register and Title documents

(iv) Accounts and Procedural Manual

(v) Payment Vouchers, Receipts, etc.

(vi) Banking& Cash transaction documents.

(vii) Monthly Payroll and Directors' Emolument.

(g) Correspondences with Tax Authorities and other third parties.

(h) Minutes of Board of Directors' and Annual General Meetings (AGM).

(i) Tax and other payment receipts, assessments, forms, Tax Clearance Certificates etc.

(j) Other Financial and Non-Financial documents including appointment letters.

The above should be kept intact in a safe place, because they may be required sighting by the Revenue Authorities, during registration, filing of assessments and tax examinations.

Documents/data to be maintained by the Tax Consultant

The following documentation/data, among others, will be maintained by the Tax Consultants in respect of each Client. The documents which will either he kept in the permanent file or forwarded to the relevant tax office will include the following:

(a) CTC of Incorporation documents i.e. Certificate of Incorporation, MEMAL Directors, Shareholders, Secretary, and Share Capital details. Etc.

(b) Engagement Letters.

(c) Company Auditors' details if different from that of Tax Consultant.

(d) Audited Financial Statements, Capital Allowances, Income Tax, Education and other Computations.

(e) Trial Balance, detailed Analysis and Schedules on the Financial Statements.

(f) Correspondences with the Client tax authorities and third parties.

(g) Registration documents in respect of Income Tax, Value Added Tax (VAT), PAYE, Withholding Tax and other Levies.

(h) Records of Billings and out standings.

(i) Other documents, financials and non-financials.

14.04 Communication with Tax Authorities

The Tax Authorities rely on documents and first-hand information provided by any Tax payer (or the tax Consultant), in determining the possible tax liabilities of the Tax Payer.

Additional information from third parties such as Banks, Insurers, Landlords, Tenants, Suppliers, Customers, Shareholders, Registrar of companies and other Stakeholders may be required by the tax authorities for assessment purposes.

Under the provision of the Federal Inland Revenue Service (Amendment) Act, 2007 and other Tax Legislations, Relevant Tax Authorities have rights to receive or demand for additional information from Tax Payers and third parties, on matters affecting any Tax Payer.

Communications with Tax Officials will usually cover the following:

(a) Registration with Tax Authorities for Income and other Taxes using Standard questionnaire.

(b) Filing of Tax Returns time limits provided by the Tax Laws.

(c) Self Assessments and Objections to Best of Judgment (BOI) assessments.

(d) Tax Queries and Replies.

14.05 Registration with Tax Authorities

The FIRS and SIRS have a Standard Questionnaire which is expected to be followed by Taxpayers for the registration under the provisions of CIT A, PITA, PPTA and other Tax Legislation/Acts.

The folioing details together with CTC of Incorporation documents (Originals to be submitted for verification), will be provided in a formal letter addressed to the Chairman of the relevant tax authority, in respect of every prospective Tax Payers:

(a) Name, Registration Number and Date of Incorporation/Registration.

(b) The Registration or Home address (as applicable)

(c) The Business address.

(d) Names and addresses of the Directors.

(e) Names and addresses of the Shareholders together with their shareholders.

(f) Any other Directorship held by the Directors.

(g) The precise Nature of business.

(h) Whether or not the business has any predecessor(s)

(i) The Date of commencement of business

(j) The Accounting year end.

(k) Details of Company Secretary (Where applicable).

(l) Details of the appointed Auditors and Tax Consultants.

(m) Details of appointed Bankers.

(n) Any other Information which may help the tax authority in this regard.

VAT Registration

A VAT-able Person or VAT Agent is required to also file application for VAT registration at the nearest FIRS office. The application will be supported with CTC of the registration documents.

Filing of Tax Returns

Any company registered in Nigeria must submit relevant information to the tax authority within six months of existence or at commencement of operations (whichever is earlier). An Individual must also provide relevant information in the specified format (Form A) at the beginning of every 'assessment year.

Filing of Tax Returns for Individuals and Corporate persons are done using prescribed self-assessment year end (whichever is earlier):

(a) Signed Audited Financial Statement together with a covering letter from the Tax Consultant.

(b) Capital Allowances and Income Tax Computation.

(c) Self-Assessment Forms for Income and Education Tax.

14.06 Self-Assessment for Individuals

Tax Returns for Individuals are submitted at the beginning of every assessment year. The Self-Assessment Form (Form A) is completed, stating various sources of Income and Allowances/Reliefs claimable. The Assessment forms must be signed and dated by the Tax Payer.

It is relevant to note here that, tax payments to both FIRS and SIRS are now made vide E-Payment at designated banks. The E-payment has therefore reduced the level of written communication with the Tax Authorities.

Best of Judgment (BOJ) Assessment

Where the Tax Payer fails to file Self-assessment forms and pay the normal tax within the time limit specified under the law, BOJ assessment is raised on the affected Tax Payer.

A valid objection must be raised within 30 days of service of such notice, stating valid ground of objection.

Tax Queries and Replies

Tax queries emanate from desk examinations of tax, returns by Tax Officials. Returns are examined, asking for supporting documents in order to ascertain whether or not the tax payers income has not been understated, reliefs not overstated or that the expenses deducted from the Income the period were ***"wholly, exclusively, necessarily and reasonably incurred"*** in the production of those incomes.

Tax Queries may not follow any specific pattern, but Tax Practitioners must have a better understanding of the Tax payer's operations, and possess adequate technical knowhow, with relevant field experience.

The following issues may be raised from related documents, collected or verified by tax officials, in order to eliminate any private or capital expenditure from the tax returns and also guide against tax avoidance shares to some reasonable extent.

(a) Whether there exists, supporting documents for Assets, Liabilities Income and Expenditures in the name of the Tax payer.

(b) Whether private expenses were included in the Accounts.

(c) Whether relevant documents such as certificate of Acceptance, Input VAT, Invoices, supporting invoices, Premium Claims, invoices on administrative and operating expenses, etc. agreed with amounts stated in the Accounts.

(d) Whether PAYE deducted from salaries and Withholding Taxes from Supplies or Professional fees were promptly remitted.

(e) Whether Capital expenditures in form of cost of increase in Capital or Incorporation expenses, general Bad Debts and Depreciation have been written back to profit.

(f) Whether losses and carry forward rules have been adequately observed.

Replies

When replying to tax queries, tax practitioners should Endeavour to be more ethical and use subtle language as much as practicable the Consultant should avoid quoting decided cases or tax laws when one is not too sure that circumstances or scenarios are similar.

Apart from the above, the Consultant should make use of relevant supporting documents from both the client's office and his working papers. Third party documents not relevant to the queries raised should not be forwarded as an attachment.

Finally, the Tax Consultant should not be seen to be involved in any practices which could be construed to be Tax Evasion, fraud or outright criminality.

Communication with Other Stakeholders

Communication with other stakeholders is specifically required to gather additional information on the clients' business.

Communication with Former Tax Consultant and Auditors

To satisfy professional ethics, an Incoming tax consultant is required to liaise with the former Consultant and/or Auditors previously in charge of the Client's tax matters.

In these circumstances, the Incoming Consultant needs to:

(a) Confirm whether or not there exists any professional reason(s) why they should not accept the appointment.

(b) Obtain relevant documents, Audited Accounts, tax computations and background information on the new assignment.

(c) Plan the assignment very well.

Communication with others

The Tax Consultant may also need to obtain further information in respect of the Client, from the following:

(a) Bankers-for Bank Statements in support of bank charges and to vouch certain entries.

(b) Insurers- For premium paid.

(c) Pension Fund Administrator- For pension Fund Certificate, to support exemptions.

(d) Other Professionals, that is, Lawyers for Legal advice.

The Tax Consultant must obtain written permission from the Client, in support of third parties evidence. One should exercise the duty of reasonable care in making use of any third parties' evidence.

14.07 Tax Avoidance and Tax Evasion

Every assesse (taxpayer) wants to escape from paying taxes, which encourages them to use various means to avoid such payment. Obviously, when it is about savings the taxes, the two most common practices that can be seen all around the world are tax avoidance and tax evasion. **Tax avoidance** is an exercise in which the tax payer legally tries to defeat the basic intention of the law, by taking advantage of the shortcomings in the legislature (surbhi, 2015:1).

On the contrary, **tax evasion** is a practice of reducing tax liability through illegal means, i.e. by suppressing income or inflating expenses or by showing lower income. In other words, Tax Avoidance is completely lawful because only those means are employed which are legal, while Tax Evasion is considered as a crime in the whole world, as it resorts to various kinds of deliberate manipulations. To learn more differences, on the given topics, read the article provided below. Definition of Tax Avoidance

An arrangement made to beat the intent of the law by taking unfair advantage of the shortcomings in the tax rules is known as Tax Avoidance. It refers to finding out new methods or tools to avoid the payment of taxes which are within the limits of the law.

This can be done by adjusting the accounts in a manner that it will not violate any tax rules as well as the tax incurrence will also be minimized. Formerly tax avoidance is considered as lawful, but now it comes to the category of crime in some special cases.

The only purpose of tax avoidance is to postpone or shift or eliminate the tax liability. This can be done investing in government schemes and offers like the tax credit, tax privileges, deductions, exemptions, etc., which will result in the reduction in the tax liability without making any offence or breach of law.

Definition of Tax Evasion

An illegal act, made to escape from paying taxes is known as Tax Evasion. Such illegal practices can be deliberate concealment of income, manipulation in accounts, disclosure of unreal expenses for deductions, showing personal expenditure as business expenses, overstatement of tax credit or exemptions suppression of profits and capital gains, etc. This will result in the disclosure of income which is not the actual income earned by the entity.

Tax Evasion is a criminal activity for which the particular taxpayer is subject to punishment under the law. It involves acts like:

- Deliberate misrepresentation of material facts.

- Hiding relevant documents.
- Not maintaining complete records of all the transactions.
- Making false statements.

Key Differences between Tax Avoidance and Tax Evasion

The following are the major differences between Tax Avoidance and Tax Evasion:

1. A planning made to reduce the tax burden without infringement of the legislature is known as Tax Avoidance. An unlawful act, done to avoid tax payment is known as Tax Evasion.
2. Tax avoidance refers to hedging of tax, but tax evasion implies the suppression of tax.
3. Tax avoidance is immoral that tends to bend the law without causing any damage to it. Unlike tax evasion, this is illegal and objectionable both according to law and morality.
4. Tax avoidance aims at minimizing the tax burden by applying the script of law. However, tax evasion minimizes the tax liability by exercising unfair means.
5. Tax Avoidance involves taking benefit of the loopholes in the law. Conversely, Tax Evasion includes the deliberate concealment of material facts.
6. The arrangement for tax avoidance is made prior to the occurrence of tax liability. Unlike Tax Evasion, where the arrangements for it, are made after the occurrence of the tax liability.
7. Tax avoidance is completely legal however Tax Evasion is a criminal activity.
8. The result of tax avoidance is the postponement of tax, whereas the consequence of tax evasion if the individual is found guilty of doing so is either imprisonment or penalty or both.

Note:

Tax Avoidance and Tax Evasion both are meant to reduce the tax liability ultimately but what makes the difference is that the former is justified in the eyes of the law as it does not make any offence or breaks any law. However, it is biased as the honest tax payers are not fools, but they can also make arrangements for postponing unnecessary tax. If we talk about the latter, it is completely unjustified because it is a fraudulent activity, because it involves the acts which are forbidden by the law and hence it is punishable.

14.08 Review Questions

a. Identify the documents required for clients' documentation and records

b. Discuss the scope of communications with tax officials

c. Comment on the key differences between tax avoidance and tax evasion

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