Professional level

ICAN

Advanced Taxation

The Institute of Chartered Accountants of Nigeria

Published by
The Institute of Chartered Accountants of Nigeria
PC 16, Idowu Taylor Street
Victoria Island
Lagos, Nigeria
Email: info.ican@ican.org.ng
www.ican-ngr.org

ISBN 978-978-53304-4-1

© The Institute of Chartered Accountants of Nigeria, December 2014

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, scanning or otherwise, without the prior permission in writing of The Institute of Chartered Accountants of Nigeria, or as expressly permitted by law, or under the terms agreed with the appropriate reprographics rights organisation.

You must not circulate this book in any other binding or cover and you must impose the same condition on any acquirer.

Notice

The Institute of Chartered Accountants of Nigeria has made every effort to ensure that at the time of writing the contents of this study text are accurate, but neither the Council of the Institute of Chartered Accountants of Nigeria, nor its management or employees shall be under any liability whatsoever for any inaccurate or misleading information this work could contain.

Foreword

The business environment has been undergoing rapid changes caused, in the main, by globalisation and advancement in Information Technology. The impact of these changes on the Finance function and the skills set needed by professional Accountants to perform their various tasks have been profound. These developments have made it inevitable for the Institute's syllabus and training curriculum to be changed to align its content with current and future needs of the users of Accounting services.

Although the Institute of Chartered Accountants of Nigeria (ICAN) traditionally changes its syllabus and training curriculum every five years, it had to embark on a comprehensive review of its 2010 Syllabus in 2012, that is, barely two years into the syllabus! Through a World Bank-sponsored twinning programme with the Institute of Chartered Accountants in England and Wales (ICAEW), the Project Implementation Committee, the Examinations and Students Affairs Committees worked assiduously to produce a new 3-level, 16-subject ICAN syllabus. As approved by the Council, Examinations under the new syllabus will commence with the November 2014 diet.

It is instructive to note that the last two syllabus review exercises were accompanied with the publication of study packs. Indeed, when the first and second editions of study packs were produced, the performances of professional examination candidates significantly improved. In an effort to consolidate on these gains and to further enhance the success rates of students in its qualifying examinations, the Council approved that a new set of learning materials (study packs) be developed for each of the new subjects. The Council also resolved to wholly finance the project since it was outside the scope of the World Bank grant. Although these learning materials may be regarded as the third edition, they are completely different in content, innovation and quality.

While ICAEW developed the Case Study learning material, eleven of the new learning materials were contracted to Emile Woolf International, UK. Also, renowned writers and reviewers which comprised eminent scholars and practitioners with tremendous

experiences in their areas of specialisation, were sourced locally to develop learning materials for four of the new subjects because of their local content. In effect, for the first time, there are now ICAN learning materials (study packs) for Case Study and Business Law. The 16 subjects are as follows:

FOUNDATION LEVEL

1.	Quantitative Techniques in Business	EWI
2.	Financial Accounting	EWI
3.	Management Information	EWI
4.	Business Law	Locally developed
5.	Business and Finance	EWI

SKILLS LEVEL

6.	Financial Reporting	EWI
7.	Audit and Assurance	EWI
8.	Taxation	Locally developed
9.	Performance Management	EWI
10.	Management, Governance and Ethics	EWI
11.	Public Sector Accounting and Finance	Locally developed

PROFESSIONAL LEVEL

12.	Corporate Reporting	EWI
13.	Advanced Audit and Assurance	EWI
14.	Strategic Financial Management	EWI
15.	Advanced Taxation	Locally developed
16.	Case Study	ICAEW

As part of the quality control measures, the output of the writers and reviewers were subjected to further comprehensive review by an editorial board.

Although the study packs were specially produced to assist candidates preparing for the Institute's Professional Examinations, we are persuaded that students of other professional bodies and tertiary institutions will find them very useful.

Isma'ila M. Zakari, BSc, mni, FCA
Chairman, Professional Examinations

Mr. Sunday A. Bammeke, BSc, FCA
Chairman, Students' Affairs

Acknowledgement

The Institute is deeply indebted to the underlisted locally-sourced rewriters, reviewers and members of the editorial board for their scholarship and erudition which led to the successful production of these new study packs. They are:

Taxation

1.	Enigbokan, Femi	Writer/Lead Reviewer
2.	Clever, Tony	Writer
3	Kajola, Sunday	Writer

Advanced Taxation

1.	Sobande, David	Writer/Lead Reviewer
2.	Owoyele, Olusola	Writer
3.	Egbedina, Olayide	Writer

Public Sector Accounting and Finance

1.	Osonuga, Timothy	Writer/Lead Reviewer
2.	Taiwo, Rafiu	Writer
3.	Agbeyangi, Babatunde	Writer
4.	Oladeji, Sunday	Reviewer
5.	Aregbeyen, Omo	Writer
6.	Adebayo, Ademola	Writer

Business Law

1.	Oladele, Olayiwola.O.	Writer/Lead Reviewer
2.	Emiaso, Miakpo	Writer
3.	Olaiya, Marian	Writer
4.	Oresanya, Lekan	Writer

The Institute also appreciates the services of its staff and the typesetter, Ogunbiyi Babatunde Julius, that provided secretarial support.

Editorial Board

Ismaila Muhammadu Zakari, B.Sc, FCA, mni	2nd DVP/Chairman,
Sunday Abayomi Bammeke, B.Sc, FCA	Council member
Abel Aig. Asein, B.Sc, MSc, MBA, ACA	Deputy Registrar, Technical Services
John Irabor Evbodaghe, MBA, FCA	Director, Examinations
I.B. Momoh, FCA	Assistant Director, Prof. Exams
Folake Olawuyi, BA. M.Sc	Assistant Director, Student Affairs

Rotimi A. Omotosho, FCA
Registrar / Chief Executive

List of Abbreviations

AA	Annual Allowance
API	American Petroleum Institute
ALUMSCO	Aluminium Smelter Company of Nigeria Limited
BOJ	Best of Judgement Assessment
BPE	Bureau for Public Enterprises
BP	Basis Period
CA	Capital Allowance
CAMA	Companies and Allied Matters Act, 2004
CGT	Capital Gains Tax (CAP CI LFN 2004)
CITA	Companies Income Tax Act (CAP C21 LFN 2004)
CTC	Certified True Copy
EFCC	Economic and Financial Crimes Commission
FBIR	Federal Board of Inland Revenue
FII	Franked Investment Income
FIRS	Federal Inland Revenue Service
FIRSB	Federal Inland Revenue Service Board
IA	Initial Allowance
IDA	Industrial Development (Income Tax Relief) Act, 1971
ITC	Investment Tax Credit
JTB	Joint Tax Board
MOU	Memorandum of Understanding
NNPC	Nigerian National Petroleum Corporation
NCP	National Council on Privatisation
NAFCON	National Fertiliser Company of Nigeria
NSITF	Nigeria Social Insurance Trust Fund

OML	Oil Mining Lease
OPEC	Organisation of Petroleum Exploring Countries
OSP	Official Selling Price
PITA	Personal Income Tax Act (CAP P8 LFN 2004)
PPTA	Petroleum Profits Tax Act (CAP P13 LFN 2004)
PSC	Production Sharing Contract
P&C	Privatisation and Commercialisation
RGT	Revised Government Take
TC	Tax Cases
TIP	Tax Inversion Penalty
TRP	Tax Reference Price
TWDV	Tax Written Down Value
VAT	Value Added Tax
WHT	Withholding Tax
YOA	Year of Assessment

Professional level

Advanced Taxation

Syllabus & Examination Questions Format

Examination Question Format

1. Each paper in Foundation level shall consist of two sections A and B

   Section A: Shall comprise twenty (20) compulsory multiple-choice questions which shall cover the entire contents of the syllabus. This section shall make up 20% of the total marks.

   Section B: Shall comprise six open-ended questions (essay, computational or scenario-based) carrying 20 marks each of which candidates will be required to answer any 4.

2. Skills and Professional levels shall comprise open-ended questions (essay, scenario-based or computational) only as follows:

   Section A: One (1) compulsory question of 30 marks.

   Section B: Three (3) questions of 20 marks each out of which a candidate is expected to attempt any two (2).

   Section C: Three (3) questions of 15 marks each out of which a candidate is expected to attempt any two (2).

UNITS **6**

Purpose

Candidates are expected to have an indepth knowledge and understanding of topics in Taxation, and will therefore be tested on deeper and advanced aspects of all the topics treated at the Skills Level B3. In addition, candidates will be tested in the areas listed in this syllabus.

Content and competencies – overview

Grid	Weighting %
1. Tax Planning and Advice	20
2. Capital Gains Tax (CGT)	15
3. Companies Income Tax	35
4. Petroleum Profits Tax (PPT)	30
Total	**100**

Content and Competencies			Chapter
1.	**TAX PLANNING AND ADVICE**		
		Tax Incentives, Tax Avoidance, Tax Planning and Tax Evasion	
	(a)	Distinguish between tax evasion and avoidance	3
	(b)	List examples of tax evasion activities	3
	(c)	List examples of tax avoidance activities	3
	(d)	Explain the concept of tax planning and tax mitigation	3
	(e)	Discuss Tax Planning activities and strategies	3
	(f)	Compare and contrast the tax incentives for Manufacturing, Agriculture, Power Plants, Export oriented Businesses	3
	(g)	Double Taxation Relief	3
	(h)	Other tax planning issues i. Thin capitalization ii. Tax havens iii. Executives on foreign assignments iv. Foreign direct investments v. Non-tax factors	3 3 3 3 3 3
2.	**CAPITAL GAINS TAX (CGT)**		
	(a)	Discuss the concept, scope and administration of Capital Gains Tax	5
	(b)	Compute chargeable Gain and Capital Gains Tax	5
	(c)	Discuss special situations under CGT	5
	(d)	Planning and Reliefs: i. Explain the provisions relating to the replacement of business assets (Rollover relief) ii. Explain the provisions relating to delayed remittances	5 5
	(e)	Outline and explain the offences and penalty	5
3.	**COMPANIES TAX**		
	(a)	**Companies Income Tax**	6
		i. Ascertain the tax liability of companies based on: ♦ Total profit ♦ Minimum tax ♦ Dividend distribution	6 6 6 6
		ii. Describe the detailed tax position and compute tax of specialised businesses such as: ♦ Insurance, Banks, Leasing companies ♦ Transportation and communication companies iii. Demonstrate basis period for assessment, relating to:	13 13 13

Content and Competencies				Chapter
			♦ Commencement, change of accounting date and cessation of companies ♦ Mergers and acquisitions	8 8
		iv.	Explain the taxation of non-residents companies doing business in Nigeria, either through: ♦ Introduction ♦ Fixed base, dependent agents ♦ Subsidiaries and turnkey projects	 8 8 8
		v.	Explain and compute tax on income earned from abroad, together with the application of tax rules and reliefs available as follows: ♦ Relief under CITA √ Commonwealth tax relief √ Double taxation relief ♦ Impact of double tax treaty· ♦ Resolution of conflicts between DTAs and Nigerian tax laws ♦ Nigerian double tax agreement √ Active DTAs √ Taxation of business profits, movable and immovable properties √ Taxation of investment incomes √ Dispute resolution mechanism	 11 11 11 11 11 11 11 11
		vi.	Pioneer Legislation (Industrial Development (Income Tax) Relief Act ♦ Enumerate the various pioneer industries and products on the pioneer list ♦ State the procedure for applying and obtaining pioneer status and how pioneer certificate can be amended ♦ Explain the provision relating to retrospective operations and the date of production certification ♦ Outline the conditions relating to Qualifying capital expenditure for a pioneer company ♦ Outline the circumstances for cancellation, information and publication of pioneer certificate ♦ Explain the tax relief period and the conditions or extension of the period by the National Council of Ministers ♦ What are the tax incentives available to pioneer companies? ♦ With practical illustration, explain the application of the commencement and cessation provisions to pre and post pioneer businesses,	 9 9 9 9 9 9 9

Content and Competencies			Chapter
		together with the treatment of losses and capital allowances of pioneer period ♦ Outline the various restrictions applicable to pioneer companies.	9 9
	(b)	**Tax Audit and Investigation**	
		i. Distinguish between tax audit and investigation	4
		ii. Describe the different types of tax audit exercise	4
		iii. Explain the power of the tax authority to require an audit	4
		iv. Outline the tax audit procedures, covering ♦ Pre-audit ♦ Field audit ♦ Post audit	 4 4 4
		v. Describe tax audit reconciliation and assessment procedure	4
		vi. Describe the basic elements of a valid objection and appeal covering ♦ Time limit for objection and appeal ♦ Content of a notice of objection and appeal ♦ Amendment of assessment and refusal to amend ♦ Appeal procedures and process: Tax Appeal Tribunal, Federal High Court etc	 2 2 2 2
		vii. Analyse the main triggers of tax investigation and state the procedures involved	4
		viii. Outline the provisions backing the power to distrain for non-payment	4
		ix. Explain ethical issue – implication of confidentiality, conflict of interest and disclosure of information on tax practice	1
		x. Advice on interpretation of tax laws using decided cases	15
		xi. Explain and illustrate the nature of communication with clients, tax authorities and other stakeholders	1
		xii. Outline the procedure for the presentation of cases before a Tax Appeal Tribunal	2
	(c)	**i. Introduction to transfer pricing**	
		♦ Definition of transfer pricing by reference to the OECD, UN, PATA guidelines ♦ Outline the use of transfer pricing by multinationals and justify the introduction of transfer pricing regulations by developing countries	10 10

Content and Competencies			Chapter
		ii. Describe the provisions of the Nigerian Transfer Pricing Regulations, covering:	
		♦ Purpose, objectives and commencement date	10
		♦ Outline the Scope of the Nigerian TP regulations	10
		♦ Define connected taxable persons	10
		♦ Explain the recommended transfer pricing methods (Traditional, transactional and any other method)	10
		♦ Explain the provisions relating to Advance pricing agreement	10
		♦ Explain abd illustrate functional analysis	10
		♦ Outline and explain the basic comparability factors in the process of TP benchmarking	10
		♦ Outline the basic documentation requirements for transfer pricing benchmarking	10
4.	**PETROLEUM PROFITS TAX (PPT)**		
	(a)	Give a general overview of the Oil and Gas industry in Nigeria, covering activities in the upstream, midstream, downstream, gas utilization and oil sector.	14
	(b)	Outline the basic roles of the Regulatory Agencies in the oil and gas sectors, such as the NNPC, NAPPIMS, DPR, CBN, FIRS	14
	(c)	Compare and contrast the Fiscal/Operating Arrangement/ regimes in the upstream sector, with emphasis on the following: i. Joint Venture	14
		ii. Production Sharing Contract	14
		iii. Risk Service Arrangement	14
		iv. Oil and Gas Free Trade Zones	14
		v. Marginal Field Operations	14
	(d)	With respect to Petroleum Profits Tax, explain the basis of assessment and what constitutes Accounting period for tax purposes	14
	(e)	Ascertain the basic sources of income accruing to petroleum companies and compute the Adjusted profit, Assessable profit, Chargeable profit and the Petroleum Profits tax	14
	(f)	Outline the expenses allowable and those not allowed as a deduction in computing Adjusted profit	14
	(g)	Explain the treatment of losses for petroleum companies	14
	(h)	Identify and describe qualifying capital expenditure for capital allowance purposes and compute capital allowance claimable by petroleum companies	14

Content and Competencies			Chapter
	(i)	Compute PPT under JV, PSC, Marginal Field Operations, Companies within the first five years	14
	(j)	Explain and compute tax based on the incentives available to companies that signed PSC agreement with the Federal Government of Nigeria	14
	(k)	Describe the basic tax regime applicable to sole risk operators and marginal field operators	14
	(l)	Outline the offences and penalties applicable to petroleum companies	14
	(m)	Describe the registration requirements and returns filing for petroleum companies (Estimated tax returns and final returns).	14

Table of Contents

Front Page i
Foreword iii
Acknowledgement v
List of Abbreviations vii
Syllabus and Examination Questions Format ix
Table of Contents xvii

CHAPTER 1: TAX ADMINISTRATION 1
1.0 Purpose 2
1.1 Introduction To Tax Administration 2
1.1.1 Federal Inland Revenue Service Board 2
1.1.2 Joint Tax Board (JTB) 4
1.1.3 State Board of Internal Revenue 5
1.1.4 Joint State Revenue Committee 6
1.1.5 The Local Government Tax Authority 7
1.1.6 Limitations of Tax Administration 8
1.2 Communication with Clients 8
1.2.1 Appointment of a Tax Consultant 8
1.2.2 Acceptance of Offer as Tax Consultant 10
1.3 Communication with Tax Authorities 11
1.3.1 Registration with Tax Authorities 11
1.3.2 VAT Registration 12
1.3.3 Filing of Tax Returns 12
1.3.4 Due Date for Payment of Tax 12
1.3.5 Self Assessment for Individuals 13
1.4 Tax Queries and Replies 15
1.5 Communication with other Stakeholders 16
1.5.1 Communication with Former Tax Consultant and Auditors 16
1.5.2 Communication with Others 16
1.6 Clients Documentation and Records 16
1.6.1 Documentation/information to be maintained/ provided by Clients 17
1.6.2 Documentation/data to be maintained by the Tax Consultant 17

1.7 Chapter Review 18
1.8 Worked Examples 18
1.8.1 Questions 18
1.8.2 Suggested Solutions 20

CHAPTER 2: OBJECTIONS AND APPEAL 31
2.0 Purpose 32
2.1 Objection and Appeal Procedures 32
2.2 Establishment of a Tax Appeal Tribunal 33
2.2.1 Power of the Minister 33
2.2.2 Composition of the Tribunal 33
2.2.3 Constitution of a Tribunal 34
2.2.4 Appointment of Secretary to the Tribunal 34
2.2.5 Appointment of Other Staff of the Tribunal 35
2.3 Jurisdiction of The Tribunal 35
2.4 Criminal Prosecution 35
2.5 Appeals to the Tribunal 36
2.5.1 Notice of Appeal 36
2.5.2 Notice of Refusal to Amend 36
2.5.3 Appeals from Decisions of the Service (FIRS) 36
2.5.4 Appeals by the Service 37
2.5.5 Procedure before Tax Appeal Tribunal 37
2.5.6 Procedure following Decision of the Tribunal 39
2.6 Appeal to the Federal High Court 39
2.7 Right to Legal Representation 40
2.7.1 Powers and Procedures of Tribunal 40
2.8 Further Appeal to the Court of Appeal 41
2.9 Chapter Review 41
2.10 Worked Examples 41
2.10.1 Questions 41
2.10.2 Suggested Solutions 45

CHAPTER 3: TAX PLANNING AND INCENTIVES 49
3.0 Purpose 50
3.1 Tax Planning 50
3.1.1 Direct Taxes 50
3.1.2 Indirect Taxes 50
3.1.3 Tax Planning Checklist 52
3.2 Tax Avoidance 53
3.2.1 Anti-Avoidance Legislation 54
3.3 Tax Avoidance and Tax Evasion 57
3.4 Tax Incentives 58
3.4.1 Industrial Sector 59
3.4.2 Oil & Gas Sector 63
3.4.3 Petroleum Industry 64

3.4.4 Agriculture 64
3.4.5 Solid Minerals 65
3.4.6 Tourism 65
3.4.7 Energy sector 65
3.4.8 Telecommunications 65
3.4.9 Tax incentives for other lines of trade 66
3.4.10 Export incentives for non-oil sector 66
3.5 Benefits and Criticisms Of Tax Incentives 68
3.5.1 Benefits: 68
3.5.2 Criticisms of Tax Incentives 68
3.6 Other Tax Planning Issues 69
3.6.1 Thin Capitalisation 69
3.6.2 Tax Haven 71
Introduction 71
3.6.3 Executives on Foreign Assignments 75
3.6.4 Foreign Direct Investment 75
3.6.5 Non-Tax Factors 76
3.7 Chapter Review 77
3.8 Worked Examples Questions 77
3.8.1 Questions 77
3.8.2 Suggested Solutions 80

CHAPTER 4: TAX AUDIT AND INVESTIGATION 89
4.0 Purpose 90
4.1 Introduction 90
4.2 Tax Audits 91
4.4 The Tax Audit Branch 92
4.5 Types of Tax Audit 92
4.6 The Tax Audit Process 92
4.6.1 Pre Assessment Stage 92
4.6.2 Assessment Stage 93
4.6.3 Selection of Taxpayer to Be Audited 93
4.6.4 Preliminary Review of Taxpayer's File 94
4.6.5 Notification of Taxpayer 97
4.6.6 Pre-Audit Meeting followed by Field Audit 98
4.6.7 Post Audit Meeting 99
4.6.8 Interim Audit Reports 99
4.6.9 Post Audit Review by Regional/ Headquarters Auditors Audit 99
4.6.10 Reconciliation Meetings 100
4.6.11 Final Audit Report 100
4.7 Types of Audit Exercise 101
4.7.1 Technical Procedures 101
4.8 Audit Programme 103
4.9 Tax Investigations 104
4.10 Stages of tax investigation 104

4.11 Investigation/Intelligence Division 105
4.12 Civil Investigations Unit 106
4.13 Criminal Investigation Unit 107
4.14 Intelligence Unit 108
4.15 Assessment of Investigation/Intelligence Division 109
4.16 Chapter Review 109
4.17 Worked Examples 110
4.17.1 Questions 110
4.17.2 Suggested Solutions 111

CHAPTER 5: CAPITAL GAINS TAX 117
5.0 Purpose 118
5.1 Nature and Objectives of Capital Gains Tax 118
5.2 Administration Of Capital Gains Tax 119
5.3 Allowable and Disallowable Expenditure 120
5.4 Rate 120
5.5 Computation of Chargeable Gains 121
5.6 Exemptions From Capital Gains Tax 121
5.8 Disposal and Acquisition of Assets 123
5.9 Reliefs 130
5.9.1 Delayed Remittances Relief 130
5.9.2 Roll-Over Relief (Section 32 CGT Act) 131
5.10 Offences and Penalties 134
5.11 Other Matters 134
5.12 Chapter Review 136
5.13 Worked Examples 137
5.13.1 Questions 137
5.13.2 Suggested Solutions 140

CHAPTER 6: ASCERTAINMENT OF TAX LIABILITIES 149
6.0 Purpose 150
6.1 Introduction 150
6.2 Imposition 151
6.3 Trade or Business 153
6.4 Dividends 153
6.4.1 Payment of dividend by a Nigerian Company 154
6.4.2 Nigerian dividends received by companies other than Nigerian companies 154
6.5 Authorised Unit Trust Scheme 155
6.6 Exemptions 156
6.7 Determination of Profits 160
6.8 Allowable Deductions 161
6.9 Disallowable Expenditure 167
6.10 Waiver or refund of liability or expense 168
6.11 Basis of Assessment 169
6.12 Company in partnership with another 176

6.13 Total Profits and Sources of Profits 176
6.14 Losses 179
6.15 Normal Company Tax Rate 180
6.16 Tertiary Education Tax 181
6.18 Small Business Rate 185
6.19 Pre-operation Levy 186
6.20 Information Technology 186
6.21 Withholding Tax 186
6.21.1 Introduction 186
6.21.2 Enabling Laws 187
6.21.3 Withholding Tax Rates, Remittances and Tax Authorities 187
6.21.4 Credit Notes 188
6.21.5 Dual Roles of Collection Agents 189
6.21.6 Advance Income Tax Payment 189
6.22 Capital Allowances 190
6.22.1 Introduction 190
6.22.2 Qualifying Expenditure 190
6.22.3 Assets Acquired on Hire-Purchase 191
6.22.4 Points to Note Regarding Capital Allowances 193
6.22.5 Basis Period 196
6.22.6 Buildings, Structures or Works of a Permanent Nature .. 196
6.22.7 Mines, Oil Wells or Other Sources of Mineral Deposits of a Wasting Nature 197
6.22.8 Plantations 197
6.22.9 Allowances 198
6.22.10 Capital Allowances Rates 201
6.22.11 Claim for Capital Allowances – Options 202
6.23 Deferred Taxation 203
6.24 Chapter Review 208
6.25 Worked Examples 209
6.25.1 Questions 209
6.25.2 Suggested Solutions 212

CHAPTER 7: PERSONS CHARGEABLE, OFFENCES AND PENALTIES..... 223
7.0 Purpose 224
7.1 Introduction 224
7.2 Chargeability to Tax 224
7.3 Persons Answerable 224
7.4 Directors Appointment of Agent (Section 38) 225
7.5 Company in Liquidation (Section 40) 225
7.6 Company's Representative on Tax Matters 225
7.7 Offences and Penalties 225
7.9 Other Offences and Penalties 229
7.9.1 Duty of Secrecy and confidentiality 229
7.9.2 Obstruction of officials in their duties 229

7.9.3 Investment allowance improperly claimed 229
7.9.4 Failure to Render a Return 230
7.9.5 Failure by Banks to Disclose Information 230
7.9.6 Offences on Withholding Tax 231
7.9.7 Failure to Pay Tax on Due Date 231
7.10 Chapter Review 231
7.11 Worked Examples 232
7.11.1 Questions 232
7.11.2 Suggesed Solutions 233

CHAPTER 8: TAXATION OF NON-RESIDENTS 237
8.0 Purpose 238
8.1 Introduction 238
8.2 Chargeability to Tax Resident Individuals 238
8.2.1 Resident Individual and Liability to Tax 238
8.2.2 Non-resident Individual 238
8.3 Resident and Non-resident Companies 239
8.3.1 Resident Companies 239
8.3.2 Non-Resident Companies 239
8.4 Dual Residence 240
8.4.1 Dual Residence or Individuals (Local) 240
8.4.2 Local Dual Residence of a Company 240
8.4.3 International Dual Residence 240
8.5 Branches and the Parent Company 241
8.6 Subsidiaries and the Parent Company 241
8.7 Comparison of Overseas Branch with Overseas Subsidiary 242
8.7.1 Overseas Branch 242
8.7.2 Overseas Subsidiary 242
8.8 Treatment Of Expenses 242
8.9 Profits Or Income “Deemed to be Derived from Nigeria” 242
8.9.1 Fixed Base of Business 243
8.9.2 Operation of a Dependent Agent 243
8.9.3 Profits on a Turnkey Project 244
8.9.4 Transactions not at Arm’s Length 244
8.9.5 “Sales’ Outlet” 245
8.9.6 Employment Income 245
8.10 Chapter Review 245
8.11 Worked Examples 246
8.11.1 Questions 246
8.11.2 Suggested Solutions 248

CHAPTER 9: PIONEER LEGISLATION 253
9.0 Purpose 254
9.1 Introduction 254
9.2 Pioneer Conditions 254
9.3 Application for Pioneer Status 255

9.4 Production day 255
9.5 Certification of qualifying capital expenditure 256
9.6 Cancellation of Pioneer Certificate 257
9.7 Income Tax Relief 257
9.8 Exempt profits and dividends therefrom 259
9.9 Offences and Penalties 259
9.10 Section 25 (IDA) 260
9.11 Nigeria LNG Limited 261
9.12 Chapter Review 262
9.13 Worked Examples 262
9.13.1 Questions 262
9.13.2 Suggested Solutions 264

CHAPTER 10: TRANSFER PRICING 271
10.0 Purpose 272
10.1 Introduction 272
10.2 Significance of Transfer Pricing 273
10.3 Legal Framework For Transfer Pricing 273
10.3.1 Highlight of the Income Tax (Transfer Pricing) Regulation Act of 2012 273
10.3.2 Purpose, Objective and Scope of Application of Transfer Pricing Regulations 274
10.4 Arm's Length Principle 275
10.5 Transfer Pricing and Multinational Companies 275
10.5.1 Different Pricing of Goods / Services at Purchase Cost 275
10.5.2 Tax Fraud 276
10.5.3 Custom Duties & Tariff Manipulation 276
10.5.4 Dividends Manipulation 276
10.5.5 Imposition of Excessive charges 276
10.6 Transfer Pricing Methods And Evaluation of Taxpayer's Controlled Transactions 277
10.6.1 Comparable Uncontrolled Price Method (CUPM) 278
10.6.2 Resale Price Method (RPM) 279
10.6.3 Cost-Plus Method (CPM) 279
10.6.4 Profit Split Method (PSM) 280
10.6.5 Transactional Net Margin Method (TNMM) 280
10.7 Documentation 280
10.7.1 Transfer Pricing Policy 281
10.7.2 Transfer Pricing Disclosure and Submission to FIRS 281
10.8 Key Definition and other Issues to be Considered in Transfer Pricing 281
10.8.1 Controlled Transaction 281
10.8.2 Connected Taxable Persons 281
10.9 Arm's Length Comparability Factors in Transfer Pricing 282
10.10 Administration of Transfer Pricing Regulation 282

10.11 Chapter Review 283
10.12 Worked Examples 283
10.12.1 Questions 283
10.12.2 Suggested Solutions 284

CHAPTER 11: DOUBLE TAXATION ARRANGEMENT 289
11.0 Purpose 290
11.1 Double Taxation Relief 290
11.1.1 Introduction 290
11.1.2 Commonwealth Income Tax Relief Section 33(1) deals with the Nigerian Companies. 291
11.1.3 Double Taxation Agreement 292
11.1.4 Double taxation agreement with United Kingdom 293
11.3 Impact of Double Taxation 294
11.4 Resolution of Conflicts Between DTA's and Nigerian Tax Laws .. 294
11.5 Active Double Taxation Agreement 296
11.6 Taxation of Business Profits, Immovable and Movable Properties 297
11.7 Taxation of Investments Income 298
11.8 Chapter Review 300
11.9 Worked Examples 300
11.9.1 Questions 300
11.9.2 Suggested Solutions 301

CHAPTER 12: MERGERS AND ACQUISITIONS 305
12.0 Purpose 306
12.1 Introduction 306
12.2 Mergers, Acquisitions And Takeovers 307
12.2.1 Mergers 307
12.2.2 Trade or Business Sold or Transferred: Section 29(9) 308
12.2.3 Reconstituted Companies: Section 29 (10) 308
12.3 The Main Highlights 309
12.4 Chapter Review 310
12.5 Worked Examples 310
12.5.1 Questions 310
12.5.2 Suggested Solutions 311

CHAPTER 13: TAXATION OF SPECIAL BUSINESSES 315
13.0 Purpose 316
13.1 Introduction 316
13.2 Tax Distortion under Inflationary Conditions 316
13.3 Special Businesses 317
13.3.1 Introduction 317
13.3.2 Shipping or air transport / courier companies 317
13.3.3 Taxation of Insurance companies 318
13.4 Chapter Review 323

13.5 Worked Examples 323
13.5.1 Questions 323
13.5.2 Suggested Solutions 327

CHAPTER 14: PETROLEUM PROFITS TAX 335
14.0 Purpose 336
14.1 Introduction 336
14.2 Definitions as given in PPTA 341
14.3 Administration of Petroleum Profits Tat Act 344
14.4 Nature and Classification of Income 348
14.5 Nature and Classification of Costs 349
14.6 Ascertainment of Adjusted Profits and Imposition of Tax 353
14.7 Allowable and Non-allowable Deductions 356
14.8 Treatment of Losses in Petroleum Profits Tax Computations 360
14.9 Capital Allowances 360
14.10 Ascertainment of Assessable Tax and Chargeable Tax 368
14.11 Concepts and Computations of Posted Prices 372
14.12 Business Sold or Transferred (Section 17) 373
14.13 Reconstituted Company (Section 18) 374
14.14 Accounts and Particulars 375
14.15 Assessment and Appeal Procedures (Section 35) 377
14.16 Persons Chargeable 385
14.17 Collection and repayment of tax 386
14.18 Deduction of Tax at Source 388
14.19 Offences and Penalties 390
14.20 Double Taxation Arrangement (Section 61) 392
14.21 Memorandum of Understanding (MOU) 395
14.22 Companies Engaged In Utilization of Associated Gas 401
14.23 Joint Venture and Production Sharing Contracts 402
14.24 Chapter Review 405
14.25 Worked Examples 407
14.25.1 Questions 407
14.25.2 Suggested Solutions 410

CHAPTER 15: INTERPRETATION OF TAX LAWS 415
15.0 Purpose 416
15.1 Introduction 416
15.2 Cardinal Rules for Interpretation of Taxing Statutes 417
15.2.1 Rule of Literal Interpretation 417
15.2.3 Golden Rule (Doctrine of Purposive Construction) 418
15.2.4 Rule of harmonious construction 418
15.2.5 Doctrine of 'reading down' 418
15.2.6 Rule of Beneficial Construction 418
15.2.7 Charging sections to be strictly construed while benevolent and procedural sections should be liberally construed. 419

15.2.8 Mischief rule (Heydon's case 1584) .3 Co. Rep.7a, 7b 420
15.2.9 Construction of penal provisions 421
15.2.10 Rule of 'Ejusdem Generis' or Noscitur a Sociis 421
15.2.11 Rule of 'Expressio Unius Est Exclusio Alterius' (Expression of one thing implies Exclusion of other Similar Things) 422
15.2.12 External aids to interpretation 422
15.2.13 Generalia Specialibus Non Derogant: (General provisions must yield to the special provision)422
15.2.14 Mimansa Rules of Interpretation 423
15.2.15 Miscellaneous 424
15.3 Chapter Review 425
15.4 Worked Examples 425
15.4.1 Questions 425
15.4.2 Suggested Solutions 426

APPENDIX I: GLOSSARY OF TERMS 433

APPENDIX II: STUDY AND EXAMINATION TECHNIQUES 443

APPENDIX III: DECIDED TAX CASES 449

APPENDIX IV: BIBLIOGRAPHY 479

INDEX 481

CHAPTER 1

Tax Administration

Contents

1. Purpose
2. Introduction to Tax Administration
3. Communication with Clients
4. Communication with Tax Authority
5. Communication with Other Stakeholders
6. Clients Documentation and Records
7. Chapter Review
8. Worked Examples

1

TAX ADMINISTRATION

1.0 PURPOSE

After studying this chapter, readers should be able to:

(a) understand the provisions of the Federal Inland Revenue Service (Amendment) Act 2007, the composition and functions of the Federal Inland Revenue Service Board;

(b) establish powers conferred on the Federal Inland Revenue Service regarding administration and enforcement of various tax laws;

(c) appreciate the powers and objectives of the Service's enquiries;

(d) identify various types of assessment;

(e) know filing, assessment and collection procedures; and

(f) know the code of ethics expected of Revenue officials.

1.1 INTRODUCTION TO TAX ADMINISTRATION

Presently, there are three (3) tiers of government charged with the administration of tax in Nigeria: the Federal, State and Local Governments.

Each tier of Government has its own tax authority, created by Federal Laws. The authorities include:

1.1.1 Federal Inland Revenue Service Board

The administration of taxation on the profits of incorporated companies is vested in the Federal Inland Revenue Service (FIRS) whose management board is known as the Federal Inland Revenue Service Board (FIRSB) (Sections 1-3 FIRS Establishment Act, 2007).

Composition of the FIRSB

The Federal Inland Revenue Service Board comprises:

(a) Executive Chairman – who shall be a person within the service, to be appointed by the President;

(b) Six members with relevant qualifications and expertise, to 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 N.N.P.C. 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) 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.

The members of the Board, other than the Executive Chairman, shall be part-time members. Also, the Chairman and other members of the Board, other than ex-officio members shall each hold office:
(i) For a term of 4 years renewable once only; and
(ii) On such terms and conditions as may be specified in the letter of appointment.

Powers and Functions of FIRSB

The Board shall:
(a) Provide the general policy 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 pensions of staff and employees in consultation with the National Salaries, Income and Wages Commission; and
(f) Do such other things, which in its opinion, are necessary to ensure the efficient performance of the functions of the Service under the Act.

Duties of the Secretary to the FIRSB (Section 12)

There shall be a Secretary to the Board who shall be appointed by the Board within the FIRS whose duties are to:
(i) Issue notices of meetings of the Board;
(ii) Keep records of the proceedings of the Board; and
(iii) Carry out such duties as the Executive Chairman or the Board may, from time to time, direct.

In order to assist the FIRS in the performance of its duties, provision is made in Section 9 for the setting up of a committee of the Board, to be known as "The Technical Committee".

Composition of the Technical Committee

The Technical Committee shall consist of:

(a) The Executive Chairman of FIRS as Chairman of the committee;
(b) All Directors and Heads of departments of the FIRS;
(c) The Legal Adviser to FIRS; and
(d) Secretary to FIRSB.

The Technical Committee may co-opt from the Service, such staff as it may deem necessary, for the effective performance of its functions under the Act.

Functions of the Technical Committee, Federal Inland Revenue Service Board

(a) To consider all tax matters that require professional and technical expertise and make recommendations to the Board;
(b) To advise the Board on any aspect of the functions and powers of the FIRS; and
(c) To attend to such other matters as may from time to time be referred to it by the Board.

1.1.2 Joint Tax Board (JTB)

Section 86 of the Personal Income Tax Act Cap P8 LFN 2004 (as amended) established the Joint Tax Board (JTB).

Composition

The JTB comprises:

(a) The Chairman of the Federal Inland Revenue Service Board, who doubles as the Chairman of the JTB;
(b) One member from each State, being a person experienced in income tax matters, nominated either by name or office, from time to time, by the Commissioner charged with responsibility for matters relating to income tax of the State in question;
(c) The Secretary, who is not a member of the Board, and is appointed by the Federal Civil Service Commission; and
(d) The Legal Adviser of the FIRS acts as the Legal Adviser to the JTB.

Quorum

Seven members or their representatives shall constitute a quorum {Section 86 (6)}.

Functions of the JTB

The Board shall:

(a) Exercise the powers or duties conferred on it by the PITA and other Acts;

(b) Advise the Federal Government, on request, in respect of double taxation arrangement with any other country;

(c) Advise the Federal Government, on request, in respect of rates of capital allowances and other taxation matters, having effect throughout Nigeria in respect of any proposed amendment to PITA;

(d) Promote uniformity, both in the application of PITA and in the incidence of tax on individuals throughout Nigeria; and

(e) Impose its decisions on matters of procedure and interpretation of PITA, on any State, for purposes of conforming to agreed procedures or interpretations.

1.1.3 State Board of Internal Revenue

Composition:

(a) The Executive Chairman of the State Service who shall be a person experienced in taxation appointed by the State Governor from within the State Service;

(b) The Directors and Heads of Department within State Service;

(c) A Director from the State Ministry of Finance;

(d) Three persons nominated by the Commissioner of Finance in the state on their personal merit;

(e) A Legal Adviser to the State Service; and

(f) The secretary to the State Service who shall be an ex-officio member.

Functions and Powers

(a) The State Board is responsible for the assessment for the assessment and collection of Pay As You Earn (PAYE) and other Personal Income Tax.

(b) Ensuring the effectiveness and optimum collection of all taxes and penalties due to government.

(c) Doing all such things as may be deemed necessary and expedient for the assessment and collection of and account for all amounts so collected in a manner to be prescribed by the Commissioner.

(d) Making recommendation, where appropriate, to the JTB on tax policy, tax reforms, tax legislation, tax treaties and exemptions as may be required from time to time.

(e) Generally controlling the management of the State Service on matters of policy, subject to the provision of the law setting up the State Service.
(f) Appointing, promoting, transferring and imposing discipline on employees of the State Service.

Technical Committee of SBIR
Composition:
(a) Executive Chairman as Chairman
(b) All Directors and Heads of Department of the State Internal Revenue Service
(c) The Legal Adviser to the Board
(d) The Board Secretary

Functions:
(a) Consider all matters that require professional and technical expertise and make recommendations to the Board
(b) Advise the board on its power and duties
(c) Attend to such other matters that may from time to time be referred to it.

1.1.4 Joint State Revenue Committee

According to the Act, each State of the Federation should have a joint State Revenue Committee, comprising:

(a) The Chairman of the State Board of Internal Revenue who acts as Chairman of the Committee;
(b) The Chairman of the Local Government Revenue committee;
(c) A Representative of the Bureau of Local Government Affairs - (from the rank of Director and above);
(d) A Representative of the Revenue Mobilisation, Allocation and Fiscal Commission, as observer;
(e) State Sector Commander of the FRSC as observer;
(f) Legal Adviser of the State Internal Revenue Service; and
(g) Secretary to the Committee, usually a staff of the SIRS

Functions of the Joint State Revenue Committee, the Committee is expected to:

(a) Implement decisions of the Joint Tax Revenue Service;
(b) Advise the Joint Tax Revenue Service, the State and Local Governments on revenue matters;
(c) Harmonise Tax Administration in the State;

(d) Enlighten the public generally on State and Local Government revenue matters; and

(e) Execute such other functions as may from time to time be assigned by the Joint Tax Revenue Service.

1.1.5 The Local Government Tax Authority

Local Government Revenue Committee (Section 85 D & E of Personal Income Tax Act Cap P8 LFN 2004).

(a) **Composition**

The Revenue Committee shall comprise:

(i) The Supervisor for Finance as Chairman;

(ii) Three Local Government Councilors as members; and

(iii) Two other persons experienced in revenue matters to be nominated by the Chairman of the Local Governments on their personal merits.

(b) **Functions**

(i) The Revenue Committee shall be responsible for the assessment and collection 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) The Revenue Committee shall be autonomous of the Local Government Treasury department and shall be responsible for the day-to-day administration of the department which forms its operational arm.

(c) **Taxing Power**

Under the 1999 Constitution of the Federal Republic of Nigeria, only the Federal Government has the exclusive power to legislate and impose Stamp Duties and Taxes on Incomes, Profits and Capital Gains, both for individuals and corporate bodies, by way of Acts. It exercises the powers through the Joint Tax Revenue Service.

Prior to 1993, various States imposed one form of tax or the other by way of Edicts. The promulgation of the Personal Income Tax Act 104 of 1993, repealed all such Edicts and replaced them with a uniform structure throughout the Federation.

Whilst, the power to impose taxes on individuals and corporate bodies is under the Exclusive list of the Constitution, that is, exclusive to the Federal Government, the collection of the taxes is under the Concurrent List, which means that the power to collect

the various taxes has been split between the three tiers of Government - Act 21 of 1993.

1.1.6 Limitations of Tax Administration

The following are constraints to effective tax administration in Nigeria:

(a) Poor public enlightenment;

(b) Inadequate funding of tax authorities;

(c) Dearth of qualified and / or experienced tax officials at the State and Local Government tiers of Government;

(d) Tax evasion;

(e) Improper use of Tax Consultants;

(f) Lack of will power on the part of personnel of tax authorities (Administrative ineffectiveness);

(g) Loop holes in the Law; and

(h) Poor governance.

1.2 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. Taxpayers are of two categories:

(a) Individual taxpayers; and
(b) Corporate taxpayers.

Individual taxpayers file tax returns to State Board Internal Revenue Service (SBIR), while Corporate taxpayers (usually Companies) file returns with the Federal Inland Revenue Service (FIRS).

It is, therefore, important 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.

1.2.1 Appointment of a Tax Consultant

(a) Appointment of a Tax Consultant is usually communicated vide Letter of engagement emanating from the taxpayer to the Tax Consultant.

(b) A typical Letter of Appointment is shown below:

ILLUSTRATION 1.1

Letter of Appointment as Tax Consultant written on the Letterhead of DDB NIGERIA LTD.

25 April 2009
The Managing Partner
XYZ Consult
28A, Jaja Way
Ikeja, Lagos.

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 as Tax Consultants to our Company with immediate effect.

Please note that the services to be rendered include, tax matters of employees, directors and the company.

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, 30 April 2009, by 2 pm at our Ikeja head office to finalise the details.

We look forward to a mutually-beneficial business relationship between our company and your organisation.

Yours faithfully,
for: **DDB NIGERIA LTD**

(Signed)
James Ikilo
Managing Director

CC: The Tax Controller
Federal Inland Revenue Service
Integrated Tax Office, Lagos.

1.2.2 Acceptance of Offer as Tax Consultant

The Acceptance of offer as Tax Consultant to a taxpayer 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.

Acceptance of offer must be communicated in writing to each client as illustrated below:

ILLUSTRATION 1.2

Specimen Letter of Acceptance

5 May 2009
The Managing Director
DDB Nigeria Limited
4, Rewrite Way
Surulere, Lagos.

Dear Sir,

ACCEPTANCE OF OFFER AS TAX CONSULTANTS

Your letter dated 25 April 2009, on the above subject 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 represent your interest with the relevant tax authorities from time to time.

We shall be pleased to meet with you as scheduled.

Thank you.

Yours faithfully,
for: XYZ Consult

(Signed)
Apple Dior
Managing Consultant

1.3 COMMUNICATION WITH TAX AUTHORITIES

The tax authorities rely on documents and first hand information provided by any taxpayer (or the Tax Consultant), in determining the possible tax liabilities of the taxpayer.

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 provisions 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 taxpayers and third parties, on matters affecting any taxpayer.

Communication with tax officials will usually cover the following:

(a) Registration with tax authorities for Income and other taxes using Standard questionnaires.

(b) Filing of tax returns within time limits provided by the tax laws.

(c) Self Assessments and Objections to Best of Judgment (BOJ) assessments.

(d) Tax queries and replies.

These are fully discussed as follows:

1.3.1 Registration with Tax Authorities

The Federal Inland Revenue Service and State Board of Internal Revenue have a standard questionnaire which are expected to be completed by taxpayers for the registration under the provisions of CITA, PITA, PPTA and other tax legislations/Acts.

The following 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 taxpayer:

(a) Name, Registration Number and Date of Incorporation/ Registration.
(b) The registered or residential address (as applicable).
(c) The business address.
(d) Names and addresses of the directors.
(e) Names and addresses of the shareholders together with their shareholdings.
(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.

1.3.2 VAT Registration

A vatable 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.

1.3.3 Filing of Tax Returns

Any company registered in Nigeria must submit relevant information to the tax authority within six months of the accounting year end. A new company must file its tax returns within 18 months of incorporation or 6 months after its first accounting period, 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 forms, with supporting documents.

The following are usually forwarded to FIRS as tax returns, within eighteen months of incorporation of the company or six months after the end of the accounting year-end (whichever is earlier):

(a) Signed Audited Financial Statements 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.

1.3.4 Due Date for Payment of Tax

Payment of Income Tax is due 2 months from the filing date in case of a lump sum payment or in case of instalmental payment, as may be approved by the FIRS, not exceeding three instalments; in this case, evidence of first instalmental payment must be submitted along with the tax returns.

Payment may be delayed until first working day of the following calendar year for companies with financial year end date between January and 30 June.

1.3.5 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 taxpayer.

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 taxpayer 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 taxpayer.

A valid objection must be raised within 30 days of service of such notice, stating valid grounds of objection.

ILLUSTRATION 1.3
Objection to BOJ Assessment

ABC Ltd is a trading company which has been operating in Nigeria for over ten years. The company is duly registered for both Income Tax and VAT and has been filing returns regularly.

Unfortunately, the Company's Accounts for the year ended 31 December 2007, could not be signed by the Directors until 1 August 2008, when the Managing Director returned from his medical trip abroad. A BOJ assessment for ₦4.5m was served on the Company with date of service of 30 July 2008. The Tax Consultant filed and paid for self assessment on 2 August 2008 as follows:

Income tax	₦2.75m
Education tax	₦260,000

The tax authority imposed a Late Returns Penalty (LRP) of ₦25,000 on the company thereafter.

Required:

As a Tax Consultant with many years of experience, write a suitable Letter of Objection to the BOJ assessment to the tax office.

SUGGESTED SOLUTION 1.3

5 August 2008

The Tax Controller
Federal Inland Revenue Service
Integrated Tax Office
Noshaking Way, Ikeja

Dear Sir,

ABC Ltd - TIN NO 00010002149

Objection to BOJ Assessment No YC/A/110/2008/1 dated 30 July 2008 for ₦4.5M

We write to raise a formal objection to the above quoted BOJ Assessment of ₦4.5m raised on our Client, Messrs ABC Limited for 2008 Assessment Year.

Please consider the following grounds of objection:

(a) Our client has been a good corporate taxpayer and has been meeting its tax obligations over the years.

(b) The Company's Accounts were audited on time, but could not be signed by the Directors until the end of July 2008, due to ill health of the Managing Director. Photocopies of his medical reports for treatment received in Toronto are attached for your perusal

(c) The BOJ Assessment was served on the company few days ago, just as we paid the Self assessments.

(d) Tax Returns and Self Assessment payments for Income tax, Education tax and LRP were submitted to your office on 2 August 2008. Please see copies attached.

We will, therefore, be grateful if you would please discharge the BOJ Assessment of ₦4.5 on compassionate ground and substitute with the Self Assessment Returns for ₦2.75m based on the income tax computations.

We sincerely thank you for your cooperation.

Yours faithfully,
For: XYZ Consult

Peter Zone
For: Managing Director

1.4 Tax Queries and Replies

Queries

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 taxpayers 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 taxpayers' operations, and possess adequate technical know - how, 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 to some reasonable extent:

(a) Whether there exists, supporting documents for assets, liabilities income and expenditure in the name of the taxpayer.

(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 expenditure 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.

1.5 COMMUNICATION WITH OTHER STAKEHOLDERS

Communication with other stakeholders is specifically required to gather additional information on the clients' business.

1.5.1 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

1.5.2 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.

1.6 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.

1.6.1 Documentation/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 fees, Board's Resolution, 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) Correspondence 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 for sighting by the Revenue Authorities, during registration, filing of assessments and tax examinations.

1.6.2 Documentation/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 be 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, MEMAT, 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 tax and other computations.
(e) Trial Balance, detailed analysis and schedules on the Financial Statements.
(f) Correspondence 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 outstanding.
(i) Other documents, financials and non-financials.

1.7 CHAPTER REVIEW

In this chapter, readers must have learnt about the following:

(a) Provisions relating to the establishment of the organs of tax administration, their compositions and functions.

(b) The extensive power of the Revenue Service to make enquiries in writing and by physical presence in the taxpayer's place of business. The assistance of police may be used by the Revenue Service in carrying out its duties. Any one that obstructs tax officers in carrying out their official duties shall be guilty of an offence and liable to a fine or imprisonment or both fine and imprisonment.

(c) Power of the Revenue Service to assess taxpayers on turnover and to disregard transactions that can be considered artificial or fictitious.
(d) The procedures of the Revenue especially on assessment and collection.
(e) Monthly tax revenue reconciliation at the Zonal and at the Headquarters.
(f) Ethical issues as regards taxpayers and tax matters on non-disclosure to unauthorised persons. Oath of Secrecy in the Civil Service and a body of "Code of Ethics" for civil servants.
(g) The legality of the actions of tax administrators and the extent of their limits.

1.8 WORKED EXAMPLES

1.8.1 Questions

(1) James Bond Nigeria Limited, based in Ibadan was incorporated in January 2012, as a producer of wallets and other safe keeping products.

The first set of audited accounts was for the year ended 31 December 2012 and it was filed by Messrs F.J. Yaba & Co to the relevant tax authority together with the tax computations.

Upon examination of the tax returns, the inspector of taxes raised some queries relating to the following expenses:

(i) Bank charges;
(ii) Electricity expenses;
(iii) Hotel expenses;

(iv) Cost of equipment;
(v) Building costs;
(vi) Purchase of raw materials;
(vii) Salaries and wages;
(viii) Directors' fees;
(ix) Business insurances; and
(x) Rent.

Required:
Assuming you are the Inspector of Taxes, do a letter to the tax consultants requesting for the relevant documents evidencing the various expenses noted above.

(2) An Ibadan based textile manufacturer - Deptec Ventures Nigeria Limited - was incorporated on 1 July 2011, but commenced business in January 2013.

The financial year-end of the company is 31 December. The Board of Deptec Ventures Nigeria limited has just appointed your firm as the company's External Auditors and you have been duly informed.

Assume that the necessary audited accounts have been prepared by your firm in accordance with the provisions of the relevant laws.
Required:
Draft a letter addressed to the appropriate tax authority stating the following:
(a) The audited financial statements attached, in accordance with the provisions of the Companies and Allied Matters Act, CAP C20, LFN 2004 (as amended);
(b) Relevant year of assessment; and
(c) Any other information required to accompany the first set of returns as an agent of Deptec Ventures Nigeria limited.

(3) Eye Service Limited was incorporated as a limited liability company on 25 February 2012. The major object clause of the company as stated in its Memorandum of Association is "to carry out Eye Services generally".

It has an Authorized Share Capital of N1,000,000 Ordinary Shares of N1.00, fully allotted to the three subscribers, who are also the founding directors as stated in the incorporation documents presented to you.

You have just been appointed as the first Tax Consultants to the company, whose registered and business address is located at 22c, Crossroads Lane, Idumota, Lagos. The Company commenced operations at exactly 2 pm on Monday, 4 May 2012.

Required:

Draft suitable letters to the appropriate tax office for Income Tax and VAT registration purposes.

(4) The success achieved by Federal Inland Revenue Service (FIRS) in meeting the revenue targets set for its Integrated Tax offices nationwide was seen as a challenge by its State counterpart, i.e. State Board of Internal Revenue (SBIR). As a result, the Chairman of New State Board of Internal Revenue , in a bid to increase the revenue drive from the self-employed category, announced various incentives to staff who are able to meet the targets set.

You have been engaged as the Tax Consultant to the Chairman of New State Board of Internal Revenue.

Required:

Advise the Chairman of New State Board of Internal Revenue in:

(a) Identifying constraints facing the tax authorities in the assessment and collection of taxes from self-employed taxpayers; and

(b) Evolving strategies for expanding the Nigerian tax net to improve tax collection from the self employed category of taxpayers.

1.8.2 Suggested Solutions

(1) **Letterhead of the Tax Office**

O/R Y/R 18 October 2013

The Tax Partner
Messrs F. J. Yaba & Co.
Tolulope Street
Molete, Ibadan.

Dear Sir,

JAMES BOND NIGERIA LIMITED
RE: AUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

We refer to the tax returns filed on behalf of your client, for the year ended 31 December 2012, together with the tax computations for 2012 and 2013 Years of assessments.

Having examined the accounts and the accompanying schedules, it becomes highly imperative to seek for more clarifications on some of the expenses incurred by your client. To this end, we

hereby request for some documents evidencing the various expenses as follows:

(a) Bank charges
Give details of your client's bankers and provide us with all the bank statements from January to December 2012.

(b) Electricity expenses
Forward copies of all electricity bills for the year under review.

(c) Hotel expenses
All hotel bills for the year under review are needed.

(d) Cost of equipment
All invoices and receipts evidencing payments and delivery of the equipment to be submitted.

(e) Building costs
Building plan, survey plan, receipts and invoices, vouchers, certificate of occupancy, architect's certificates are needed.

(f) Purchase of raw materials
Receipts and invoices, Goods Received Notes, waybills and stock cards are required.

(g) Salaries and Wages
Staff payroll, evidence of remittance of PAYE and appointment letters are required.

(h) Directors' fees
Forward evidence of withholding tax deducted and remitted to the Board of Internal Revenue and vouchers for payments of Directors' fees.

(i) Business insurances
Insurance policies, receipts issued by insurance companies and claims received, if any, are to be submitted.

(j) Rent
Rent agreements, receipt issued by the landlord, evidence of deduction and payment of Withholding tax and vouchers are required.

It is our hope that you will expedite action in this regard by providing all the evidence without delay. Kindly respond to our queries within 30 days after the date of this letter.

Thanks for your anticipated cooperation.

Yours faithfully,
for: Ibadan Integrated Tax Office

J. O. AGBELOBA
Inspector of Taxes.

(2)

XYZ & Co.

(Chartered Accountants)
Plot 10, Oke-Ado Street, Ibadan.

1 October 2005

The Tax Controller
Federal Inland Revenue Service
Ibadan Area office
Ibadan.

Dear Sir,

DEPTEC VENTURES NIGERIA LIMITED
REGISTRATION OF THE COMPANY FOR TAX PURPOSES

We wish to inform you that we have been appointed as the External Auditors to the above-named company and we also have instructions to file all necessary documents with your office.

Please find enclosed herewith, copies of the Statement of Affairs for the period ended December 31, 2012 (18 months) and audited financial accounts for year ended December 31 2013. Also included, are the copies of the relevant tax computations for 2013 and 2014 Years of assessment.

The following documents/information are supplied for record purposes:

(a) A reply to your questionnaires
(b) Names and addresses of directors
(c) Copy of the Memorandum and Articles of Association
(d) Copy of the Certification of Incorporation (original available for sighting)

(e) Copy of the form, containing the particulars of Directors duly stamped by the Corporate Affairs Commission
(f) Accounting year-end is December 31, every year
(g) Letters of appointment of our firm as the External auditors and Tax Consultants addressed to you, by our client
(h) Date of commencement of business – January 2013
(i) The company manufactures textiles
(j) The company's registered address is 2, Ajanlekoko Street, Oke Ado, Ibadan.

It is our hope that the accounts will be examined as early as possible to facilitate the early payment of the tax due.

Thank you for your anticipated co-operation in this regard.

Yours faithfully
For: XYZ & Co.

James Jaiyesimi
Managing Partner

3 (a)

ACC & Co.

(Chartered Accountants)
3, Lane Avenue, Lagos.

O/R: FIRS/IT/12/01 Y/R: 6 May 2012.

The Tax Controller
Federal Inland Revenue Service
Idumota Integrated Tax Office
4, Idumota Road
Lagos.

Dear Sir,

EYE SERVICE LIMITED (RC:105449
APPLICATION FOR REGISTRATION FOR VAT PURPOSES

We wish to register the above-named company for VAT purposes. The following information / documents which will enable you open a tax file are as follows:

1. The company was incorporated on 25 February 2012.

2. The registered and business address of the Company is 22C, Crossroads Lane, Idumota, Lagos.
3. The Company is in the business of providing Eye Services,
4. The Company commenced business on 4 May 2012.
5. The accounting year-end is31 December each year.
6. The appointed banker is Long-Time Bank Ltd., 40, Idumota Road, Lagos.
7. The particulars of the shareholders are as follows::

Names	No of Shares Held
(a) Mr. Dindi Moloko	700,000
(b) Chief (Mrs) Tina Moloko	150,000
(c) Mrs. Sundie Moloko	150,000
	1,000,000

8. The Directors and their addresses are:

Name		Address
Mr. Dindi Moloko	-	15, Moloko Way, Dolphin Estate, Ikoyi, Lagos.
Chief (Mrs) Tina Moloko	-	15, Moloko Way, Dolphin Estate, Ikoyi, Lagos.
Mrs. Sundie Moloko	-	15, Moloko Way, Dolphin Estate, Ikoyi, Lagos.

9. The Directors have no other directorship.
10. The appointed Auditors/Tax Consultant is:
    Messrs **XYZ & Company**
    3, Full-time Road
    Ikeja, Lagos.

The Certified True Copies (CTC) of the Certificate of Incorporation, Memorandum and Articles of Association, Directors and Shares Allotment forms are attached herewith. The originals of these documents will be presented to you for sighting.

The Letter of Introduction of the newly appointed Auditors / Tax Consultants is attached for your records.

Thanks for your anticipated assistance.

Yours faithfully,
for: ACC & Co.

James Ahmadu
for: Managing Partner

Cc: **The Managing Director**
Eye Service Limited
22c, Crossroads Lane
Idumota
Lagos.

3(b)

ACC & Co.

(Chartered Accountants)
3, Lane Avenue, Lagos.

O/R Y/R 6 May 2012

The Tax Controller
Federal Inland Revenue Service
Idumota Integrated Tax Office
4, Idumota Road
Lagos.

Dear Sir,

EYE SERVICE LIMITED
APPLICATION FOR VAT REGISTRATION

We wish to register the above-named company for VAT purposes.

The registered address of the company is 22c, Crossroads Lane, Idumota, Lagos.

Please find enclosed herewith, a copy of the Certificate of incorporation and a letter of appointment of the auditors.

Thanking you for your anticipated assistance.

Yours faithfully,
for: ACC & Co.

James Ahmadu
for: Managing Director

Cc: The Managing Director
Eye Service Limited
22c, Crossroads Lane
Idumota
Lagos.

(4)

ABC & Co.

(Chartered Accountants)
11 Edith Muhammad Street
Ojodu, Lagos.

O/R Y/R 25 May 2013

The Chairman
New State Board of Internal Revenue
Lagos
Nigeria.

Dear Sir,

RE : ASSESSMENT AND COLLECTION OF TAXES FROM SELF-EMPLOYED TAXPAYERS

We refer to our recent appointment as Consultant to New State Internal Revenue Service for the purpose of advising on the above subject and would like to comment as follows:

Self-employed taxpayers are unincorporated individuals or body of individuals engaged in their own businesses either as Sole Traders or in Partnerships. Such persons include individual contractors, traders, professionals, consultants, market women, artisans and all other entities that are not liable to tax under the Companies Income Tax Act, but under the Personal Income Tax Act. This means such persons are taxable on Income accruing to them personally.

All self-employed taxpayers are required to file self-assessment tax returns with the relevant State tax authorities every year. Such tax return is expected to disclose transactions relating to the individuals income for the year.

(a) Constraints being faced by tax authorities in assessing and collecting taxes from self-employed taxpayers include:

(i) **Lack of Taxpayers' Data / Information**

There is no detailed information on or database for the self-employed in Nigeria, thus bringing them into the tax net is difficult.

(ii) **Inefficient Utilization of Tax Revenue**

There is a general apathy to voluntary compliance with the provisions of the tax laws because of the level of decay in basic

infrastructure which has always called to question the need for continued payment of tax in Nigeria.

(iii) **Tax Evasion and Avoidance**

It is easier for self-employed persons to evade tax than employees whose incomes are taxed at source. Also self-employed persons have evolved several tax avoidance strategies which require anti-avoidance provisions.

(iv) **Lack of Experience and Suitable Qualified Personnel**

There is the dearth of experienced tax personnel, hence the difficulty in ascertaining the correct assessments for self-employed taxpayers.

(v) **Inadequate Penalties / Absence of Enforcement**

In Nigeria, the penalties for non-compliance with relevant tax provisions are too lenient to compel the self-employed to pay tax. There is also a general lack of enforcement of existing penalties.

(vi) **Inadequate Records**

Most self-employed persons do not maintain records of their Income and Expenditure. Some also mix their business activities with their private affairs, thus making it difficult to determine the income taxable.

(vii) **Lack of Public Enlightenment**

Most taxpayers do not know what tax to pay, when to pay, who to pay to, where to pay and what reliefs and allowances they are entitled to. A good tax system should be certain and easy to administer. The public should be educated on their responsibility with respect to tax at all times.

(viii) **Level of Corruption**

Some tax officials collude with would-be taxpayers to defraud the government of taxes.

(ix) **Level of Poverty**

Several self-employed persons are struggling to survive due to the unconducive operating environment. The society has been impoverished by the elite so much that paying tax will further impoverish the low income earners.

(x) The over-dependence on oil revenue for a very long time has led to the neglect of all other non-oil revenue sources.

(b) Strategies for expanding the Nigerian Tax net to improve tax collection drive covering the self-employed.

Having enumerated the constraints facing the tax authorities in assessing and collection of taxes from the self-employed taxpayers, the following

strategies can be adopted to enhance compliance by self-employed taxpayers.

(i) **Public Enlightenment and Education**

The Revenue should embark on aggressive publicity and education of taxpayers on the various taxes payable by all self-employed individuals.

(ii) **Enforcement of Withholding Tax Provision**

By further encouraging companies to implement the withholding tax provision, more self-employed persons who render various services to companies can be brought into the 'tax net'.

(iii) **Requirement for Presentation of Tax Clearance Certificate (TCC)**

By providing and insisting that TCC be produced for any form of transaction with government, more self-employed persons will be compelled to pay their taxes.

(iv) **Stiffer Penalties for Non-Compliance**

If the consequences of failure to comply with the provisions of the tax laws are made stiffer, more taxpayers will willingly comply with the tax laws.

(v) **Encouragement of Cooperative Unions**

By encouraging artisans in particular, to form associations through which government can reach the members, improvement in tax revenue generation from that category of self-employed persons will be achieved.

(vi) **Effective Utilization of Tax Revenue**

Improvement in the level of basic infrastructural facilities will encourage voluntary compliance with provisions of the tax laws as they will show that the tax Revenue is being utilized effectively.

(vii) **Promulgation of Anti-Avoidance Provision**

Making provisions to block the several loop holes in the tax laws will enhance further compliance with the tax laws and increase tax revenue.

(viii) **Use of Information Technology**

The use of appropriate information technology that will make it difficult to evade tax will enhance tax revenue from self-employed taxpayers.

(ix) **Investigation and Intelligence Unit**

The investigation and intelligence units of the Revenue should be vibrant and effective. It is the responsibility of these units to trace self-employed persons in the society who have not been paying their taxes. This can be done by going through the Land

Registry and Vehicle Licencing Offices. Information can also be obtained from banks by insisting that they should file returns of all their new customers with the Revenue.

(x) **Engagement of Experienced and Qualified Personnel**

Employing qualified personnel and paying competitive remuneration will further enhance dedication to duty and ultimately increase tax revenue.

(xi) **Regular Amendment to the Tax Laws**

The tax laws should be regularly updated and the provisions should be such that are reasonable and easy to comply with. Most of the provisions of the Nigerian tax laws are out-dated and make it difficult to comply with. Some of those provisions encourage tax evasion.

Please do not hesitate to contact the undersigned, should you require further clarifications.

Yours faithfully,
for: ABC & Co.

Oki Ahmed
for: Managing Partner

CHAPTER 2

Objections and Appeal

Contents

1. Purpose
2. Objection and Appeal Procedures
3. Establishment of Tax Appeal Tribunal
4. Jurisdiction of the Tribunal
5. Criminal Prosecution
6. Appeals to the Tribunal
7. Appeal to the Federal High Court
8. Right to Legal Representation
9. Further Appeal to the Court of Appeal
10. Chapter Review
11. Worked Examples

2

OBJECTIONS AND APPEAL

2.0 PURPOSE

After studying this chapter, readers should be able to:

(a) know the Composition and Jurisdiction of Tax Appeal Tribunal;
(b) understand what constitutes an appeal;
(c) know the procedure for raising objections to tax assessments;
(d) know the procedure for the hearing of appeals;
(e) know the procedure to be followed for further appeals to the High Court or Court of Appeal; and
(f) know taxpayers rights in a dispute.

2.1 OBJECTION AND APPEAL PROCEDURES

(a) Where a taxpayer receives a notice of assessment, he either agrees with it or he is aggrieved. Where he agrees with the assessment, the position of the law is that the tax must be remitted within the statutory time limit of sixty days from the date of receipt of the assessment.

(b) Where he is aggrieved however, he is expected to raise a NOTICE OF OBJECTION. The notice of objection must be valid for it to have any effect.

For a notice of objection be valid, such a notice:

(i) Must have been made in writing

(ii) Must have been made within 30 days of the receipt of the Notice of assessment

(iii) Must contain the grounds of objection.

(c) Upon the receipt of the valid notice of objection, the relevant tax authority will examine the grounds of objection to determine their validity. Where the grounds are found to be valid, the tax computation would be reviewed and a revised or amended assessment raised. Payment would be based on the revised amendment.

(d) Where the relevant tax authority believes that there is no merit in the notice of objection, then a NOTICE OF REFUSAL TO AMEND would be sent to the taxpayer.

(e) The taxpayer, if aggrieved by the notice of refusal to amend, should file a NOTICE OF APPEAL to the Tax Appeal Tribunal within 30 days of the receipt of the notice of refusal to amend.

Information required in a Valid Notice of Appeal
For a notice of appeal to be valid, the following information must be included:
(i) The tax file number
(ii) The relevant year of assessment
(iii) The date the notice of refusal to amend was received
(iv) The Assessable profit for the year of assessment being disputed
(v) The Taxable profit being disputed
(vi) The amount of tax payable disputed
(vii) The grounds of appeal. Note that the grounds of appeal may not be different from the grounds of objection.

2.2 ESTABLISHMENT OF A TAX APPEAL TRIBUNAL

The Tax Appeal Tribunal was established by section 59(1) of the Federal Inland Revenue Service (Establishment) Act 2007, as provided for in the Fifth schedule to the Act.

2.2.1 Power of the Minister

According to the Act, 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.

2.2.2 Composition of the Tribunal

The tribunal shall consist of five members (hereinafter referred to as "Tax Appeal Commissioners") to be appointed by the Minister.

Appointment and meetings of the Tribunal

(a) 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 matters.

(b) A Chairman shall preside at every sitting of the Tribunal and in his absence, the members shall appoint one of them as the Chairman.

(c) The quorum at any sitting of the Tribunal shall be three (3) members.

(d) A person shall not be qualified for appointment as a Tax Appeal Commissioner unless he is knowledgeable in 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.

(e) A Tax Appeal Commissioner shall hold office for a term of three (3) 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.

(f) 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.

(g) 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.

(h) The salary and allowances payable to and the terms and conditions of service of the Tax Appeal Commissioners shall be determined by the Revenue Mobilisation Allowance 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.

(i) If for any 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.

2.2.3 Constitution of a Tribunal

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.

2.2.4 Appointment of Secretary to the Tribunal

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

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

(ii) Be the head of the secretariat and responsible for the day-to-day administration; and

(iii) Be responsible for the direction and control of all other employees of the Tribunal.

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

2.2.5 Appointment of Other Staff of the Tribunal

(a) 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.

(b) The 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.

2.3 JURISDICTION OF THE TRIBUNAL

(a) 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 C21 LFN 2004 (as amended)
(ii) Personal Income Tax Act CAP P8 LFN 2004 (as amended)
(iii) Petroleum Profits Tax Act CAP P13 LFN 2004 (as amended)
(iv) Value Added Tax Act CAP V1 LFN 2004 (as amended)
(v) Capital Gains Tax Act CAP S8 LFN 2004; and
(vi) Any other law contained in or specified in the First Schedule to the Act or other laws made or to be made from time to time by the National Assembly.

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

2.4 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.

2.5 APPEALS TO THE TRIBUNAL

2.5.1 Notice of Appeal

A notice of appeal against an assessment shall specify the following particulars:

(a) The official number of the assessment, the date and the year for which it was made;

(b) The amount of Total profits on which the tax was charged;

(c) The amount of the tax charged;

(d) The date of service of notice of refusal by the Revenue Service to amend the assessment;

(e) The precise grounds of appeal against the assessment. These must be the same as the grounds stated in the notice of objection to the Revenue Service; and

(f) Address for service of any notice, correspondence or other documents to be given to the appellant by the Secretary to the Appeal Commissioners.

All notices, documents or correspondence to be given to the Appeal Commissioners shall be addressed to the Secretary to the Appeal Commissioners, in writing, before the hearing of the appeal.

A company may discontinue any appeal by it, on giving notice, in writing, to the Secretary to the Appeal Commissioners at any time before the hearing of such appeal.

Notwithstanding that a company has given notice of appeal against an assessment, the Revenue Service may revise the assessment in agreement with the company. The Revenue Service shall give notice of such agreement in writing to the Secretary to the Appeal Commissioners, at any time before the hearing of the appeal and such appeal shall be discontinued.

2.5.2 Notice of Refusal to Amend

When a notice of refusal to amend has been received by any company, the company, if it desires, can appeal against the assessment upon giving notice (notice of appeal) in writing to the Secretary of the Tax Appeal Tribunal, within thirty days from the date of service of the notice of refusal . The date of service is the date on the notice of refusal to amend and not the date of receipt of the notice by the company. A late appeal may be accepted upon an application being made to the Tax Appeal Tribunal, if there is reasonable excuse for the delay, for example, postal delays.

2.5.3 Appeals from Decisions of the Service (FIRS)

(a) 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 4.3 (a) above, may appeal against such decision or assessment or demand notice within 30 days of the service of notice(s) of assessments.

(b) 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.

(c) Where a notice of appeal is not given by the appellant as required under (a) above, 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.

2.5.4 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.

2.5.5 Procedure before Tax Appeal Tribunal

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

(b) 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.

(c) 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..

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

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

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

(g) 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:

  (i) 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 4.3 (a) above.

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

  (iii) 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.

(h) 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.

(i) 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 o such decision.

(j) Where upon the hearing of an appeal:

  (i) No accounts, books or records relating to profits were produced by or on behalf of the appellant;

  (ii) 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;

(iii) 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

(iv) 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.

2.5.6 Procedure following Decision of the Tribunal

(a) 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.

(b) An award or judgement of the Tribunal shall be enforced as if it were a judgement 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 judgement.

(c) 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 (a) of this paragraph.

2.6 APPEAL TO THE FEDERAL HIGH COURT

(a) 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.

(b) A notice of appeal filed pursuant to subparagraph (a) above shall set out all the grounds of law on which the appellant's case is based.

(c) 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 (a) to the Secretary within 30 days after the date on which such decision was given.

(d) Upon receipt of a notice of appeal, 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.

(e) 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 be hearing of an appeal under this Act.

2.7 RIGHT TO LEGAL REPRESENTATION

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

(b) 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.

2.7.1 Powers and Procedures of Tribunal

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

(b) 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 auxiliary to its functions under this Schedule.

(c) 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.

(d) The Minister may make rules prescribing the procedure to be followed in the conduct of appeals before the tribunal.

(e) However, each party to an appeal shall bear its own cost.

2.8 FURTHER APPEAL TO THE COURT OF APPEAL

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

2.9 CHAPTER REVIEW

This chapter gives a comprehensive procedure for appeals to the Tax Appeal Tribunals (Appeal Commissioners) where the taxpayer and the Revenue cannot mutually agree on the tax due. It discusses the composition and matters relating to Appeal Commissioners and other staff such as appointment, tenure of office, and so on.

The right of appeal of a taxpayer and the tax authority to seek further redress from the Federal High Court and Court of Appeal was also discussed.

In addition, decided cases on different areas of dispute between taxpayers and tax officials were also discussed.

In conclusion, good knowledge of the procedure for appeals to the Tax Appeal Tribunal and decided tax cases will improve tax practice in the country. Areas of conflict between tax practitioners and tax officials will be reduced considerably and this will be better for the country.

2.10 WORKED EXAMPLES

2.10.1 Questions

1. Your firm has been the Tax Consultants to Murideen Limited for the past five years. The company makes up accounts to 31 December each year.

   You submitted the company's tax returns to the Federal Inland Revenue Service, Lagos on 24 June 2012.

   On 28 July 2012, the company forwarded to your office a BOJ Assessment Notice served on it on 27 July 2012 and dated 20 July 2012 with number LC/0005/12.
   The tax computations which you submitted on behalf of your client showed N1,150,000 as tax payable, but the BOJ assessment notice showed a Total profit of N13,150,000 and tax payable of N3,195,000.

   The accounts also contained information on a Mercedez Benz Tractor purchased during the 2010 accounting year, for the sum of N250,000,000 which developed some fault and a sum of N10,000,000 was spent in repairing it during 2011 accounting year.

You did object to the BOJ and it was discharged. However, during the course of examination of the accounts, the tax inspector disallowed the expenses on the tractor and added it back to the profit to form the basis of an additional assessment of N3,000,000.

You duly objected to the additional assessment but the tax inspector stood his ground and sent a final demand notice for the additional assessment.

Required:

(a) Prepare the specimen letter of objection to the Federal Inland Revenue Service, Lagos on the BOJ Assessment sent to the Company.

(b) Identify the steps to be taken to seek redress in respect of the additional tax.

2. State any **FIVE** powers of the Tax Appeal Tribunal.

3. Tijani Olomowewe died of colon cancer recently. Until his death, he was the Executive Chairman of three Companies - two Sole Enterprises and one Limited Liability Company. Wewe Blocks is a block making cencern. Wewe farms is into farming and poultry business. Wewe Pharm Limited, a limited liability company is into importation and sale of medical drugs.

The block making industry as well as the farming/poultry business were located in his village of Abule Ifo, while the pharmaceutical company was located in Lagos.

Chief Olomowewe shuttled between Abule Ifo and Lagos to personally supervise activities of the three Companies. Chief Olomowewe could not trust anybody as he believed that everybody was out to steal his money.

There was business misfortune of recent. Drugs worth N43m imported by the company were confiscated and burnt by National Agency for Food, Drugs Administration and Control. The reasons given were that the drugs carried expired dates and were found to be fake as well.

Chief Olomowewe contested the primaries election into the House of Assembly and lost woefully. He could not recover a penny from the N13.5m spent on the election.

The poultry section of the agric business was not also spared of the business reverses. The drug administered on the day old chicks were found to be fake and three thousand birds were lost in the process.

The management of Wewe Pharm Limited received a letter from the Integrated Tax Office of the Federal Inland Revenue Service, Lagos, rejecting the tax returns filed.

Ms Shade Olomowewe is the First Daughter of Chief Olomowewe. She holds a B.Sc degree in Microbiology and a diploma in Financial Management from the Obafemi Awolowo University, Ife. She is planning to travel out of the country for further studies.

She sat alone in her father's sitting room, lost in thought. One, she knew that the recent business misfortune of her father might have been responsible for his sudden death. At the family meeting held immediately after the death of Chief Olomowewe, it was unanimously agreed that Shade should take over as Chairman of the business concerns.

In preparation for her new role, Shade attended a seminar at Centre for Management Development, Lagos. An extract of a paper presented to Shade is as follows:

"From the commercial standpoint, mergers and acquisitions are rescue devices employed very often to avert failures, to build sustainable competitive position and to assure growth of business organisations through more efficient utilization of existing assets...again tax considerations have occasionally provided the motive for mergers and takeovers."

Ms Shade Olomowewe bubbling with fresh ideas as a result of the seminar she attended called an emergency meeting of the management of the Company to intimate them of her vision and dream for the company. She lectured the meeting on the need to radically re-design the whole operations through discarding old structures and procedures and inventing new ways of accomplishing tasks and processes. The following decisions were taken at the meeting:

(a) To appoint James Fowler & Co., a firm of Tax Practitioners to take up the tax appeal with the Federal Inland Revenue Service;
(b) To appoint Biadoo and Company to advise the company on the restructuring and re-engineering of every aspect of the business, management board, business processes, e.t.c.
(c) To sell the building owned by Wewe Pharm Limited in order to raise funds; and
(d) To consider the proposal for acquisition of an Airline.

The building which was initially built at a cost of ₦100m in 2003 was sold for ₦85m only. The cost of rectifying certain defects in the building and valuation fee was ₦2m.

Shade had received a call from a friend Nathaniel, a 31-year-old Cameroonian born lawyer, who had founded Sky Airlines, which was currently facing financial difficulties. Nathaniel was seeking additional financing to get the Airline airborne again. This was the proposal referred to Biadoo and Company for professional advice.

Biadoo and Company in their report highlighted the dangers in entering the Airline business. These include the high capital needed, lack of previous experience and the highly seasonal nature of the business. The case of a similar Airline that had been pushed into bankruptcy by high debts, currency fluctuations and competition from other established foreign airlines, was analysed in the report. Biadoo and Company recommended the proposal only on the condition of being able to raise appropriate finance and experienced personnel.

Despite all these reservations and obstacles, Ms Shade Olomowewe invested in the business and got Wewede Airlines registered in Lagos with a paid-up capital of N750m and acquired Sky Airlines. Wewede Airline's low fares began to attract customers.

The Profit and Loss Account of Wewede Airlines, a company incorporated in Lagos, confirmed the good vision and management acumen of Ms Shade Olomowewe. She had become a role model for the youth both in Nigeria and Cameroun on how to successfully run a business. The financial results in respect of the year ended 31 December, 2008 are as follows:

	₦	₦
Income from passengers freight-out of Nigeria		600,000,000
Income from passengers freight-into Nigeria		2,000,000,000
Income from passengers freight on other routes		7,200,000,000
		9,800,000,000
Deduct:		
Administration expenses	3,240,000,000	
Marketing expenses	360,000,000	
Financial expenses	680,000,000	
Depreciation	1,176,000,000	5,456,000,000
Net Profit		4,344,000,000

The other operating expenses of N191.5m were disallowed.

A problem arose again in respect of Wewe Pharm Limited when the tax authority rejected its tax returns for 2009 assessment year. The Federal Inland Revenue Service had dissallowed the ₦13.5m spent on political campaign and demanded for additional tax payment of ₦1,050,000.

Required:

With the rejection of the tax returns filed by Wewe Pharm Limited, enumerate the procedure to be followed in appealing against the stand of FIRS.

(4) What are the tax implications of effecting merger through liquidation and selling or transferring one Corporate business entity to another corporate body for cash or any other consideration under the Provisions of CAMA and CITA?

2.10.2 Suggested Solutions

1.

XYZ & Co.

(Chartered Accountants)
3, Aina Street, Ojodu, Lagos.

O/R **Y/R** 10 August 2008

The Chairman
Federal Inland Revenue Service
Integrated Tax Office
Broad Street
Lagos.

Dear Sir,

MURIDEEN LIMITED
NOTICE OF OBJECTION TO BOJ ASSESSMENT

We write on behalf of our above-named client and wish to acknowledge the receipt of your Notice of Assessment as detailed below:

Assessment Notice No	:	LC/0005/08
Date of Assessment	:	July 20, 2008
Date of Delivery	:	July 27, 2008
Period of Assessment	:	1/1/2008 - 31/12/2008
Total Profit	:	N13,150,000
Tax Payable	:	N3,195,000

We write to object to the said assessment based on the following grounds:-

(a) That the Best of Judgement Assessment of N3,195,000 is arbitrary, excessive, punitive and without basis.
(b) The returns for the Assessment Year 2008 based on the accounts for the year ended 31 December 2007, were filed on 24 June 2008, which was within the due date.
(c) The tax computations, the duly filed Self Assessment Form together with the tax receipts were included in the returns, all of which have been disregarded by you.

We, therefore, appeal to you to discharge the Best of Judgement Assessment raised on our client and accept the tax returns already sent to your office.

While looking forward to receiving your letter of discharge, we use this opportunity to thank you for your understanding and co-operation.

Yours faithfully,
for: XYZ & Co.

Peter Saint
for: Managing Partner

(b) Steps to resolve the additional tax

(i) Write to object to the final demand notice of the additional assessment raised.

(ii) In the objection letter, refer to the relevant section of CITA (sec.20) that states that expenses on repairs and cost of spare parts for Plant, Tools etc; are to be treated as allowable expenses for income tax purposes.
(iii) Schedule a reconciliation meeting with the Tax Inspector.
(iv) Ensure that you receive a response from the Inspector in writing, communicating their position based on the reconciliation meeting you had with them.
(v) After the meeting, if they refuse to discharge the demand notice, advise your client of your intention to proceed to the Tax Appeal Tribunal (TAT).
(vi) File a notice of appeal with the Tax Appeal Tribunal and serve the tax office a copy of the notice of appeal.
(vii) Attend the Appeal Tribunal with relevant documents to prove that the expense was wholly incurred by your client.
(viii) If the decision of the Tax Appeal Tribunal is not favourable, advise your client to arrange for a legal adviser in order to commence court proceedings up to Supreme Court.

(2) The Tax Appeal Tribunal has powers to;

- (i) Summon and enforce the attendance of any person and examine him/her on oath.
- (ii) Request for 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.
- (viii) Do anything which in the opinion of the Tribunal is incidental or ancillary to its functions.

(3) **CONTENTS OF NOTICE OF APPEAL**

Any company which is aggrieved by an assessment made upon it and has failed to agree with the Board, may appeal against the assessment to the Appeal Commissioners upon giving notice in writing to the Board within 30 days after the date of service upon such company of notice of the refusal of the Board to amend the assessment as desired.

The notice of appeal should state the following:

- (a) The official number of the assessment and the year;
- (b) The amount of tax charged by such assessment;
- (c) The amount of Total profits upon which tax is charged;
- (d) The date upon which the appellant was served with notice of refusal by the Board to amend the assessment;
- (e) The precise grounds of appeal; and
- (f) An address of service of any notices and documents.

(4) **THE TAX IMPLICATIONS OF MERGERS AND ACQUISITIONS ARE:**

- (a) Income taxes may have to be paid by the shareholders of the transfer of company;
- (b) Additional taxes may result from the application of cessation provisions;
- (c) The tax liabilities of the liquidating (Transferor) company is the first charge even before any creditor can be paid;
- (d) Capital Gains tax may be due on chargeable gains accruing to the transfer of company;
- (e) Registration fees and stamp duties may be paid to legalise the scheme and these may be disallowed for tax purposes.

CHAPTER 3

Tax Planning and Incentives

Contents

1. Purpose
2. Tax Planning
3. Tax Avoidance
4. Tax Avoidance and Evasion
5. Tax Incentives
6. Benefits and Criticisms of Tax Incentives
7. Other Tax Planning Issues
8. Chapter Review
9. Worked Examples

3

TAX PLANNING AND INCENTIVES

3.0 PURPOSE

After studying this chapter, readers should be able to:

(a) understand tax planning;
(b) understand tax avoidance;
(c) be able to distinguish between tax avoidance and tax evasion;
(d) understand the nature and scope of engagement letters to Tax Consultants and corresponding letters of Acceptance by Tax Consultants;
(e) identify clients documents to be kept and maintained by Tax Practitioners;
(f) identify records to be kept by taxpayers;
(g) understand the nature and information required for registration of taxpayers with the tax authorities;
(h) give suitable replies to tax queries; and
(i) communicate effectively with other Stakeholders on clients' tax matters.

3.1 TAX PLANNING

The main taxes in Nigeria can be classified into Direct and Indirect taxes as follows:

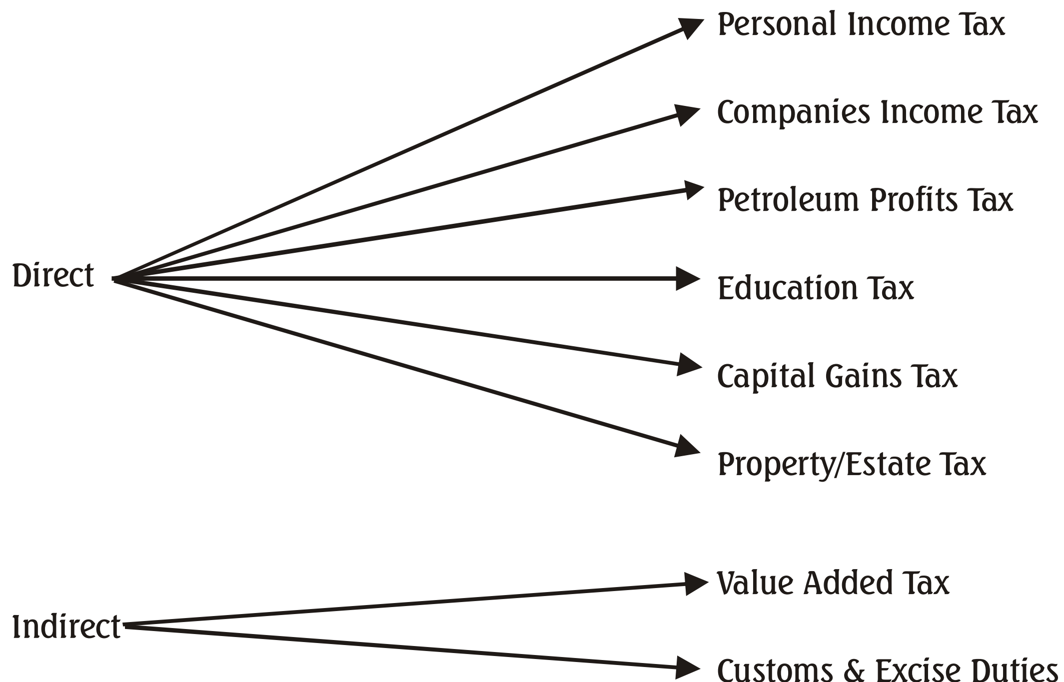
3.1.1 Direct Taxes

These are charged on a taxpayer's income, profits or other gains. They are paid by the taxpayer directly to the tax authority. The direct taxes are Personal Income Tax (payable by individuals), Companies income tax (payable by companies other than those engaged in Petroleum Operations), Petroleum Profits Tax is payable by companies engaged in petroleum operations, Education tax is payable by companies, whilst Capital Gains tax is payable by both individuals and corporate bodies.

3.1.2 Indirect Taxes

Indirect taxes are taxes imposed on commodities (goods), professional services and instruments, before they reach the ultimate consumer, client or owner respectively and are paid by them, not as taxes (i.e. not to the tax authorities), but as part of the selling/legalization price/cost, of the commodity, service or instrument, as the case may be. Examples of indirect taxes include: Value Added Tax, Custom Duties, Excise Duties and Stamp Duties.

A simple guide do determining what tax is indirect, is to acknowledge the fact that once the tax burden is not borne directly by the entity that remits the tax to the relevant tax authority, then it is an indirect tax.



Tax planning involves taking conscious efforts to consider the tax that will be payable by a taxpayer at a future date and how such tax can be minimised. It is clear that payment of tax is an outgoing from the viewpoint of a taxpayer. With respect to profits/income tax, the amount that can be retained by the taxpayer from the profits/income of his business/investments is reduced by the amount of tax that such taxpayer has to pay. Payment of tax in any country is regulated by the laws of each country. It is a statutory obligation that everyone has to comply with. Stiff penalties including imprisonment terms are usually in place in the tax legislation of each country to ensure that the taxes are paid. Since legally and morally, there may not be any way out other than to pay the tax stipulated by the laws of the country, it has been the consensus from the days of old, that taxpayers are not under any obligation to pay more tax than is necessary. Consequently, taxpayers have resorted to devising several means of ensuring that they pay the minimum possible tax.

Tax planning involves anticipating a set of circumstances and the identification of opportunities to minimise or defer tax liabilities within the law. It involves arranging affairs to ensure that the maximum allowances, exemptions and reliefs are enjoyed. Consideration would be given to the likely effect on the tax liabilities, of the timing of fixed assets acquisitions and disposals. The choice of the accounting date of a business entity, can also have a significant effect on the tax payable by

that business. The impact of the commencement rules in the tax legislation, on the taxable profits of the taxpayer, ought to be considered in tax planning, before deciding on the taxpayer's accounting date. Planning with regards to the time that the profit is earned and the timing of the payment of the applicable tax on such profit, could result in significant financial advantage to a continuing business. When a business ceases to trade permanently, the date of cessation can also impact the amount of its tax liability. In tax planning, the tax-conscious business person and the expert tax adviser, working together, can very often significantly reduce the tax liability that would be otherwise payable.

Tax planning requires detailed knowledge of tax legislation and its application to particular circumstances, identifying and taking advantage of loopholes, if any. It should also be noted that tax planning involves taking note of the applicable taxation legislation, to ensure that the tax laws are properly complied with by taxpayers, such that all taxes due are paid as at when due.

3.1.3 Tax Planning Checklist

The matters in the under-listed checklist should be considered while planning tax:

(a) List of approved taxes and levies
(b) Timing of fixed assets acquisition
(c) Timing of fixed assets disposals in view of balancing adjustments
(d) Timing of capital allowances claim and amount to claim
(e) Hire of assets as alternative to outright purchase – full hire charge is tax deductible.
(f) Where to invest
(g) Making specific instead of general provisions
(h) PAYE properly deducted
(i) Withholding tax properly deducted
(j) Note Critical Dates:
  (i) Filing of Tax Returns
  (ii) Filing of Notice of Objection
  (iii) PAYE Monthly Remittances
  (iv) PAYE Year-end Returns and Final Payment
  (v) Withholding Tax Remittances to Revenue
  (vi) VAT Returns and Remittances to Revenue
  (vii) National Social Insurance Trust Fund (NSITF)
  (viii) National Housing Fund (NHF)
  Due dates for income tax payment, to avoid penalty and interest
(k) In Capital Gains Tax (CGT), consider Roll-over Relief
(l) CGT Rate is 10%. Stocks and Shares now exempted from CGT. Invest in Stocks and Shares rather than in Buildings.

(m) Consider Current Tax Incentives
   (i) Pioneer companies
   (ii) Rural Investment allowance
   (iii) Investment tax credit
   (iv) Export processing zone allowance
   (v) Export free zone exempt profit
   (vi) Exempt profit of solid minerals mining
   (vii) Investment tax credit – spare parts fabrication
   (viii) Investment tax credit – replacement of obsolete plant
   (ix) Gas industry incentives
(n) Consider exempt income and profits (Section 19 CITA).
(o) Investment options – low or no tax investment opportunities.
(p) Dividend distribution out of Franked Investment Income.
(q) Employees remuneration.
Consider the effects of benefits in kind on taxable remuneration.

3.2 TAX AVOIDANCE

Tax avoidance arises in a situation where the taxpayer arranges his financial affairs in a form that would make him pay the least possible amount of tax. For example, avoidance of Value Added Tax can be achieved by anyone that does not buy the goods and/or services on which VAT is levied. Far from boycotting the goods or services, tax avoidance schemes are carried out after a critical review of the tax laws. The taxpayer would then implement devices to exploit loopholes in the tax laws that would enable him avoid or minimize tax. It should be noted that to a very large extent, tax avoidance is legal once it is done within the limits permissible by the tax laws.

The dictum established by the lord President (Lord Clyde) in the case Ayrshire Pullman Motor Services and David M. Ritchie v. C.I.R. several years ago still holds good.

The lord President's statement is reproduced as follows:
"No man in this country is under the smallest obligation, moral or otherwise, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow – and quite rightly – to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer is in like manner entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue."

In Federal Revenue Service of Inland Revenue v. American International Insurance Company (Nig.) Plc, Belgore C. J. stated:

"Tax is an obligation not a duty. One is not a bad citizen if one can organise his business or trade in a legal manner to minimise his tax liability. He could and he should resist within legal means any unduly wide interpretation or

unconventional implication of legislative intent of a tax law that might increase that burden. He can do so without being ashamed of walking in the street as a patriotic citizen. A shrewd business acumen and a legitimate protection of sweat of labour are not dishonest acts or an act having any moral turpitude. It is being pragmatic and practical. Being capitalistic might leave much to be desired but among what is left is not illegality."

When tax avoidance schemes are stretched to the limit, transactions would be seen only in mere form and lacking in substance. This will be because such transactions were entered into just for tax avoidance purposes. There may be no commercial effect. When this signal is present, the Revenue Service would want to step in to disallow such transactions.

To the extent that no tax law would be contravened in several tax avoidance schemes, tax avoidance is legal. This is clear from the opinions of the courts as reproduced earlier. When loopholes in tax legislation have been exploited for tax avoidance purposes, certainly the laws would not have been broken.

High rates of tax could make the cost of elaborate avoidance schemes worthwhile. This will support the view that the existence of widespread tax avoidance is evidence that the tax system requires radical reform.

The possible reaction of the Revenue Service to where loopholes in the tax legislation have been exploited is to take steps to block the loopholes. Thus specific legislation would be passed to block particular loophole or loopholes. Such is referred to as specific anti-avoidance legislation. With one loophole blocked, the taxpayer would search out other loopholes and exploit same. There are therefore, bound to be several and unending specific anti-avoidance legislation to effectively stop the taxpayer willing to carry out tax avoidance schemes. As the legislature cannot accurately foresee all schemes which the determined taxpayer could device, consideration would be given to the promulgation of general anti-avoidance legislation.

3.2.1 Anti-Avoidance Legislation

The two possible forms of anti-avoidance legislation are:

(a) Specific legislation to block known tax avoidance devices; and

(b) General anti-avoidance legislation which vests the Revenue with power to disregard all transactions entered into that could be proved to have been entered into, solely for tax avoidance purposes.

The following are some advantages and disadvantages of each of these:

(a) **Specific Anti-Avoidance**

(i) **Advantages**

- Its provisions make the law imposing tax on a particular transaction clear and certain in its application.

- Ineffective or inadequate legislation can be readily amended.

(ii) **Disadvantages**

- May make an already complex legislation more complicated and less comprehensible to taxpayers, detracting from the simplicity canon of taxation.
- The taxpayer would seek further loopholes and again exploit such for further tax avoidance which may create an unending need for further legislation.

(b) **General Anti-Avoidance**

(i) **Advantages**

- The number of anti-avoidance legislations is reduced, consequently minimising the complexity of the tax laws.

- Provisions exist in the tax legislation to discourage all future tax avoidance, that is schemes that are considered to have violated the spirit of the tax laws.

(ii) **Disadvantages**

- Provisions are general, vague and could lack precision.

- Too much reliance is placed on discretion of tax officials for its application. The tax officials could exceed the intention of the legislature in certain respects or fail to carry it out in full in some others.

In the United Kingdom, specific anti-avoidance legislation exists that gives their tax authorities the power to set aside certain tax avoidance schemes. Tax avoidance schemes that could be cancelled are:

(i) Where there existed a pre-ordained scheme, involving a number of steps, aimed at tax avoidance; or

(ii) Where steps are inserted for tax purpose without a commercial or business purpose regardless of whether they have a business effect.

The taxpayer will have a defence if he can show that:

(iii) The transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of business, and

(iv) None of the transactions had as their main object or one of their main objects the obtaining of a tax advantage.

Introduction of general anti-avoidance rules have been considered in the UK. The conclusion was that general anti-avoidance rules might be the way forward. Such have to be drafted so that there is no infringement on the rights of taxpayers and that normal commercial transactions are not jeopardised in the process.

It was reported that general anti-avoidance rules have been tried in Australia, New Zealand and Canada with little success. This could further strengthen the view that specific legislation may be more desirable.

In Nigeria, besides few specific anti-avoidance provisions scattered throughout the tax Acts, CITA Section 18 contains the general anti-avoidance provisions regarding Companies taxation. Similar provisions are contained in PITA Section 17 and PPTA Section 13 relating to Personal taxation and Petroleum Profits taxation, respectively.

CITA Section 18

Where the Revenue Service 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 be made in respect of tax liability as it considers appropriate so as to counteract the reduction of tax liability which would otherwise be affected by the transaction and any company concerned shall be assessed accordingly.

Transactions between persons, one of whom either has control over the other or, in the case of individuals, who are related to each other or between persons both of whom are controlled by some other person, shall be deemed to be artificial or fictitious, if in the opinion of the Revenue Service, 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. A company in respect of which any direction is made under this Section, shall have a right of appeal in like manner as though such direction were an assessment. The whole idea of these provisions is that where any disposition is not in fact given effect to, the consequence of which is that a tax liability which should normally arise from such disposition did not arise, the Revenue Service would want to step in. This provision is intended to cover cases where the purported transaction, if recognised as valid, would enable the taxpayer to avoid payment of income tax on that which is truly his taxable income.

The transaction(s) would be considered as artificial, that is not genuine or fictitious.

When these situations are established, the tax authority may disregard such disposition. In the alternative, the authority may direct that such adjustments shall be made in respect of the income of an individual, or an executor, or a trustee, as the authority considers appropriate so as to counteract the reduction of liability to tax effected, or reduction which would otherwise be effected by the transaction.

Summaries of two UK cases are quoted below for further illustration.

Ramsey (WT) Ltd. v. IRC (1981) STC 174
The taxpayer had implemented an elaborate tax avoidance scheme with the sole purpose of reducing a liability to CGT by creating allowable losses. The House of Lords held that although every transaction in the scheme was genuine, they were self-cancelling and the court should look at the effect of the transaction, which was to avoid tax. The scheme as a whole produced neither gain nor loss and so should be disregarded for tax purposes.

Furniss v. Dawson (1984) STC 153
The Ramsey principle was extended in this case beyond the self-cancelling transactions. A scheme would also be rejected where steps in the transaction are inserted that have no commercial purpose other than to avoid tax.

3.3 TAX AVOIDANCE AND TAX EVASION

Although tax avoidance is not an offence, the Revenue Service has power to set aside tax avoidance schemes that result in artificial or fictitious transactions. Taxpayers carrying out tax avoidance schemes will not be subject to criminal prosecutions.

Contrary-wise, tax evasion is illegal. Tax evasion is the act whereby the taxpayer can achieve the minimisation of tax through illegal means. Tax evasion involves outright fraud and deceit, for example, through deliberate omission of a source of the taxpayer's income from his return or deliberate understatement of any income. In Nigeria, tax evasion on a large scale is through failure to render tax returns. Tax evasion may be achieved by:

(a) Understating income,
(b) Overstating expenditure,
(c) Making false claims for allowances and reliefs, and
(d) Omission from tax returns of chargeable income.

Tax evasion is usually more prevalent when the tax system is perceived to be unfair. Lack of transparency in governance may also encourage tax evasion.

The Revenue Service views any case of tax evasion seriously. If discovered, the Revenue Service will go further to reopen the relevant assessments beyond the normal statutory limit of six years. A tax evader may be charged to court for criminal offences with the consequent fines, penalties and, at times, imprisonment. However, unless the amount involved is large and the taxpayer is unwilling to cooperate, the Revenue Service will usually resort to out of court settlement with a lump sum payment by the taxpayer in settlement of the tax and penalty that would have been lost if the evasion was not discovered.

Tax avoidance and tax evasion can be compared as follows:

Tax Avoidance	Tax Evasion
(i) Legal	(i) Illegal
(ii) Achievable through exploiting loopholes in the tax laws incorrect returns.	(ii) Achievable through deliberate action of fraud and deceit or redering.
(iii) Results in taxpayer paying minimum tax possible without breaking the law.	(iii) Results in taxpayer not paying correct tax or paying minimum tax through the breaking of the tax laws.
(iv) Supported by the courts in decided cases.	(iv) No support by the courts.
(v) No criminal liability.	(v) Tax evader could be charged to court for criminal offences with the consequent fines, penalties and, at times, imprisonment.
(vi) When stretched to the extreme, the scheme could be disregarded.	(vi) At any level, Revenue Service will frown at tax evasion.
(vii) No Revenue Service investigation. Prior years assessments will not be reopened.	(vii) Revenue Service investigation will be instituted. Revenue Service has the power to open prior assessments beyond the statutory six-year limit.

3.4 TAX INCENTIVES

Tax incentive is a reduction by government in the payment so as to attract that person or company to invest in a country:

Tax incentives are therefore in the tax laws to:

(a) Attract, retain or increase investment in a particular sector.

(b) Assist companies or individuals carrying on identified activities.

(c) Assist businesses carrying on identified activities.
The incentives may be granted on industry basis or on the type and may include:
(i) Exemption from payment of taxes.
(ii) Reduction in rate of tax to be paid.
(iii) Grant of allowances and deductions from profits subject to tax etc.

3.4.1 INDUSTRIAL SECTOR

TAXATION

Fiscal measures have been drawn to provide for deductions and allowances in the determination of taxable income of manufacturing enterprises, including:

Pioneer status, which is a concession to pioneer companies located in economically disadvantaged areas, providing a tax holiday period of three to five years. These industries must be considered by the government, to be beneficial to the country's economy and in the interest of the public.

Companies that are involved in local raw material development; local value added; labour intensive processing; export oriented activities; in-plant training; are also qualified for additional concessions.

Tax relief for research and development (R&D)

Up to 120% of expenses on R&D are tax deductible provided that such R&D activities are carried out in Nigeria and are connected with businesses to which allowances are granted. The result of such research could be patented and protected in accordance with internationally accepted industrial property rights.

Local raw materials utilisation:

30% tax concession for five years to industries that attain minimum local raw materials utilisation as follows:- - agro 80% - agro allied 70% - engineering 65% - chemical 60% - petro-chemical 70%

Labour intensive mode of production:

15% tax concession for five years. the rate is graduated in such a way that an industry employing one thousand persons or more will enjoy 15% tax concession while an industry employing one hundred will enjoy only 6%, while those employing two hundred will enjoy 7%, and so on.

Local value added

10% tax concession for five years. This applies essentially to engineering industries, while some finished imported products serve as inputs. This is aimed at encouraging local fabrication rather than the mere assembly of completely knocked down parts.

In-plant training

2% tax concession for five years, of the cost of the facilities for training.

Export oriented industries

10% tax concession for five years. This concession will apply to industries that export not less than 6% of their products.

Infrastructure

20% of the cost of providing basic infrastructures such as roads, water, electricity, where they do not exist, is tax deductible once and for all.

Investment in economically disadvantaged areas

100% tax holiday for seven years and additional 5% depreciation over and above the initial capital depreciation.

Excise Duty

Excise Duty is defined by the Excise Ordinance No. 64 of 1941 as "any duty other than export duty of customs imposed on any goods manufactured in Nigeria".

Excise duty is the money paid to the government by manufacturing concerns for goods produced. It is a production tax.

It was abolished with effect from 1 January 1999 but was immediately reintroduced the following year.

Goods liable to excise duty are:

- Bear and stout
- Wines
- Spirits
- Cigarettes and tobacco

that are manufactured and sold in Nigeria.

Import duty rebate

A 25% import duty rebate was introduced in 1995 to ameliorate the adverse effect of inflation and to ensure increase in capacity utilisation in the manufacturing sector. investors are however, advised to ascertain the current operative figures at the time of making an investment, because these concessions have undergone some amendments in the past few years.

Re-investment allowance

This incentive is given to manufacturing companies that incur capital expenditure for purposes of approved expansion of production capacity; modernisation of production facilities; diversification into related products. It is aimed at encouraging reinvestment of profits.

Investment tax allowance

Under this scheme, a company would enjoy generous tax allowance in respect of qualifying capital expenditure incurred within five years from the date of the approval of the project.

Dividends derived from manufacturing companies in petro-chemical and liquefied natural gas sub-sector are exempt from tax.

Companies with turnover of less than ₦1 million are taxed at a low rate of 20% for the first five years of operation if they are into manufacturing. Dividend from companies in manufacturing sector with turnover of less than ₦100 million is tax-free for the first five years of their operation.

Investment guarantees/effective protection

Transferability of funds section 24 of NIPC decree provides that a foreign investor in an enterprise shall be guaranteed unconditional transferability of funds through an authorised dealer in freely convertible currency of:

(a) Dividends or profit (net of taxes) attributable to the investment;
(b) Payments in respect of loan servicing where a foreign loan has been obtained;
(c) Remittance of proceeds (net of all taxes)and other obligations in the event of a sale or liquidation of the enterprise or
(d) Any interest attributable to the investment.

Guarantees against expropriation

By the provision of section 25 of the same NIPC decree, no enterprise shall be nationalised or expropriated by any government of the federation, unless the acquisition is in the national interest or for public purpose; and no person who owns either wholly or in part, the capital of any enterprise shall be compelled by law to surrender his interest in the capital to any other person.

These can only be done under a law that makes provision for:

(a) Payments of fair and adequate compensation; and
(b) Right of access to the courts for the determination of the investor's interest or right and the amount of compensation to which he is entitled.

In addition to all these safeguards, the Nigerian government is prepared to enter into investment protection agreement with foreign enterprises wishing to invest in Nigeria.

Access to land

Any company incorporated in Nigeria is allowed to have access to land rights for the purpose of its activity in any state in the country. It is,

however, a requirement that industrial companies comply with regulations on use of land for industrial purposes and with environmental regulations. Land lease is usually for a term of 99 years unless the company stipulates a shorter duration.

Tax Waiver on Bonds

[Companies Income Tax (Exemption of Bonds and Short Term Government Securities) Order 2011]

The following are exempt from companies income tax for 10 years effective from 2 January 2012.

(a) Short term Federal Government securities such as Treasury Bills and Promissory Notes;

(b) Bonds issued by Federal, State and Local Governments and their agencies;

(c) Bonds issued by corporate and supra-nationals; and

(d) Interest earned by holders of bonds and securities listed above.

Public Infrastructure and Employment Relief

[Companies Income Tax (Exception of Profit) Order, 2012] The commencement date is 27 April 2012 and will last for 5 years subject to the specific conditions under each incentive.

(a) **Public infrastructure incentive:** 30% of the cost of infrastructure ofa public nature will be granted as a tax deductible expense. To qualify, the infrastructure should be completed and available for public use, except where impracticable or an exemption is obtained from the Ministry of Finance.

(b) **Employing generation incentive:** Tax deduction of the lower of 5% of assessable profit or new employees' salaries can be claimed. To qualify, a company must have a minimum net employment of ten staff in assessment period. At least 60% of the net employment should relate to new graduates.

(c) **Staff retention incentive:** Tax deduction of 5% of assessable profits is available. To qualify, a company must have a minimum net employment of 5, and must have retained the employees for at least 2 years from the year of assessment when they were first employed.
Net Employment: means the difference between incoming and outgoing employees of the company in an assessment period.

Incentives to ECOWAS Countries [ECOWAS Trade Liberalisation Scheme (ETLS)]

Approved products manufactured by beneficiaries of the ETLS are allowed free access to markets within the ECOWAS region without any import duties in the destination countries.

Products approved for the scheme must satisfy the rules of origin which require at least 60% local raw materials content (volume) or 40% local raw materials value (monetary) or a minimum of 35% local value added. The cost, insurance and freight (CIF) value of imported raw material must not exceed 60% of the total cost of raw materials used.
ETLS is not fully operational going by the low level of implementation by member countries.

3.4.2 Oil & Gas Sector

The following fiscal incentives have been approved by the government in the gas production phase:

(a) Tax rate under Petroleum Profits Tax (PPT) Act to be at the same rate as company tax which is currently at 30%;
(b) Capital allowance at the rate of 20% per annum in the first 4 years, 19% in the 5th year and the remaining 1% in the books;
(c) Investment tax credit at the current rate of 5%;
(d) Royalty at the rate of 7% on shore and 5% offshore.

Gas Transmission and Distribution

(a) Capital allowance as in production phase;
(b) Tax rate as in production phase;
(c) Tax holiday under pioneer status.

LNG Projects

(a) Applicable tax rate under PPT is 45%;
(b) Capital allowance is 33% per annum onsight-straight-line basis in the first three years with with 1% remaining in the books;
(c) Investment tax credit of 10%;
(d) Royalty of 7% on shore, 5% offshore tax deductible.

Gas exploitation (upstream operations)

(a) All investments necessary to separate oil from gas from the reserves into suitable products is considered part of the oil field development;
(b) Capital investment facilities to deliver associated gas in usable form at utilisation or transfer points will be treated for fiscal purposes as part of the capital investment for oil development;
(c) Capital allowances, operating expenses and basis for assessment will be subjected to the provisions of the PPT act and the revised memorandum of understanding (MOU).

Gas Utilisation (Downstream Operations)

Incentives for encouragement of exploitation and utilisation of associated gas for commercial purpose include:

(a) An initial tax free period of three years renewable for an additional two years;
(b) 15% investment capital allowance which shall not reduce the value of the asset;
(c) All fiscal incentives under the gas utilisation down-stream operations in 1997 are to be extended to industrial projects that use gas in power plants, gas to liquid plants, fertiliser plants and gas distribution/transmission plants;
(d) The initial tax holiday is to extend from three to five years;
(e) Gas is transferred at 0% PPT and 0% royalty;
(f) Investment capital allowance is increased from 5% to 15%;
(g) Interest on loans for gas projects is to be tax deductible provided that prior approval was obtained from the federal ministry of finance before taking the loan;
(h) All dividends distributed during the tax holiday shall not be taxed.

Oil & Gas Free Zone

Incentives and fiscal measures approved by the government that favour and encourage large investment in the region include:
(a) No personal income tax;
(b) 100% repatration of capital & profit;
(c) No foreign exchange regulation;
(d) No pre-shipment inspection for goods imported into the free zone;
(e) No expatriate quota;
(f) Initial tax holidays period has been extended from 3 to 5 years and renewable for another 2 years;
(g) Investment capital allowance has been increased from 5% to 15%;
(h) All dividends distributed during the tax holiday shall be tax-free, etc.

3.4.3 Petroleum Industry

Very similar generous incentives package was granted the joint venture system and is contained in the MOU signed with oil companies.

3.4.4 Agriculture

Without prejudice to government deregulation of the financial sector, banks have been enjoined to recognise the differences in the gestation periods within each category of agricultural loans ranging from 6 months to 10 years, for crops, livestock, fisheries, forestry and wild life.
In addition, the following incentives are also available;
(a) Companies in the agro-allied business do not have their capital allowance restricted to 60% but graduated in full - 100%;

(b) Agro-allied plant and equipment enjoy enhanced capital allowances of up to 50%.

3.4.5 Solid Minerals

Nigeria is richly endowed with a variety of solid minerals of various categories ranging from precious metals, stones and industrial Minerals such as Barytes, Gypsum, Kaolin and Marble.

The ministry of solid minerals has worked out a package of attractive incentives for potential investors in the solid minerals sector, including:

(a) 3 to 5 years tax holiday;

(b) Deferred royalty payments depending on the magnitude of the investment and strategic nature of the project;

(c) Possible capitalisation of expenditure on exploration and surveys;

(d) Provision of 100% foreign ownership of mining companies or concerns;

(e) In addition to roll-over relief under the capital gains tax (cgt), companies replacing their plants and machinery are to enjoy a once-and-for-all 95% capital allowance in the first year with 5% retention value until the asset is disposed of, etc.

3.4.6 Tourism

The tourism sector was accorded preferred sector status in 1991. this makes it qualify for such incentives as tax holidays, longer years of moratorium and import duty exemption on tourism related equipment; State governments are prepared to facilitate acquisition of land through the issuance of certificate of occupancy for the purpose of tourism development;

25% of income derived from tourists by hotels in convertible currencies are tax-exempt provided such income is put in a reserve fund to be utilized within 5 years for expansion or the construction of new hotels, conference centres, etc that are useful for tourism development.

3.4.7 Energy sector

All areas of investment in this sector are considered to be pioneer product or industry. As a result, there is a tax holiday of 5 to 7 years for investments in the sector.

There has been a deregulation of this sector resulting in the emergence of independent power producers (IPP) that will soon start operation in Nigeria.

3.4.8 Telecommunications

Government provides non-fiscal incentives to private investors in addition to a tariff structure that ensures that investors recover their investment over a reasonable period of time, bearing in mind the need for differential tariffs between urban and rural areas. Rebate and tax relief are provided for the local manufacture of telecommunications equipment and provision of telecommunication services.

3.4.9 Tax incentives for other lines of trade

Companies profits in respect of goods exported from Nigeria, are exempt from tax provided the proceeds are repatriated to Nigeria and used exclusively for the purchase of raw materials, plants equipment and spare parts.

Profits of companies whose supplies are exclusively input to the manufacturing of products for exports, are excluded from tax.

All new industrial undertakings including foreign companies and individuals operating in an export processing zone (EPZ), are allowed full tax holidays for three consecutive years.

As a means of encouraging industrial technology, companies and other organisations that engage in research and development activities for commercialisation are to enjoy 20% investment tax credit on their qualifying expenditure.

All companies engaged wholly in the fabrication of tools, spare parts and simple machinery for local consumption and export are to enjoy 25% investment tax credit on their qualifying capital expenditure while any tax payer who purchases locally manufactured plants and machinery are similarly entitled to 15% investment tax credit on such fixed assets bought for use.

3.4.10 Export incentives for non-oil sector

Export Proceeds

Export proceeds can be retained in foreign currency in a domiciliary account with any authorised bank in Nigeria.

Special Export Development Fund

A special export development fund has been set up by the government to provide financial assistance to private sector exporting companies to cover a part of their initial expenses in some export promotion activities, including training courses, symposia, seminars and workshops, export market research, advertising and publicity campaigns in foreign markets, trade missions, etc.

Export Adjustment Fund

There is also an export adjustment fund scheme which serves as supplementary export subsidy to compensate exporters for the high cost of local production arising mainly from infrastructural deficiencies, and other negative factors beyond the control of the exporter.

Export Processing Zones (EPZ) Reliefs

These are zones designed to grant incentives to export oriented companies, mostly in the manufacturing sector. The following are industries permissible:

- Oil and Gas Logistics
- Electrical and Electronic Products
- Textile Products
- Garments
- Wood Products and Handicraft
- Leather Products
- Petroleum Products
- Rubber and Plastic Products
- Cosmetics and other Chemical Products
- Metal Products and Machinery
- Educational Materials and Sports Equipment
- Printing Materials, Communication and Office Equipment
- Medical Kits, Optical Instruments and Appliances
- Biscuits, Confectioneries and other Food Processing
- Pharmaceutical Products
- Ship Building and Repairs.

Proposals for industries outside the above listings will be considered on their individual merits.

Locating in any Free zone in Nigeria automatically confers upon the investor certain advantages, benefits and incentives which have been strategically designed by the Federal Government of Nigeria to create a business-friendly environment for the investor and to be competitive.

These incentives, established by Act No. 63 of 1992 and which have been improved even more in subsequent legislation, are the following:

(a) Complete holiday from all federal, state and local government taxes, rates and levies.
(b) Duty free importation of capital goods, machinery/components, spare parts, raw materials and consumable items in the zones.
(c) 100% foreign ownership of investments.
(d) 100% repatriation of capital, profits and dividends.
(e) Waiver of all imports and export licences.
(f) Waiver on all expatriate quotas.
(g) One-stop approvals for permits, operating license and importation papers.
(h) Permission to sell 100% of goods into the domestic market (However, when selling into the domestic market, applicable customs duty on imported raw material shall apply).

(i) For prohibited items in the custom territory, free zone goods are allowed for sale provided such goods meet the requirement of up to 35% domestic value addition.
(j) Waiver on all expatriate quotas for companies operating in the zones.
(k) Minimise delays in the movement of goods and services.
(l) Rent free land during the first 6 months of construction (for government owned zones).

3.5 BENEFITS AND CRITICISMS OF TAX INCENTIVES

3.5.1 Benefits:

There are some benefits derived from tax incentives even though, it is said to play a minor role in influencing investment decision into country. Some of them are;

(a) Tax incentives can be used to attract investment into the country as an indication to the reluctant foreigner that he is needed, welcomed and would be well treated.
(b) It is a convenient tool to attract industries that will help to solve unemployment.
(c) It improves the commercial profitability of Investment by making available tax-free income within the tax holiday period, which are re-invested in assists and the establishment of other industries.
(d) It also serves to establish a favourable investment climate and provide the desired assurance against confiscation and against non-convertibility especially in developing countries including Nigeria where there are different problems like currency restrictions, instability of government and the risk that foreign capital investment may be expropriated etc.
(e) Tax incentives helps in drawing attention to the profit prospects of investing in certain types of business that a country seeks to promote.
(f) It is also necessary so as to compete with the international capital market
(g) It also increases the profit prospects of a new venture and enables a firm to recover its capital costs faster so that the risks of investment are reduced considerably.

Having looked at some beneficial aspects of tax incentives, we will now look at some criticisms that have leveled against it.

3.5.2 Criticisms of Tax Incentives

(a) It has been criticized on the ground that most tax incentives laws are new and empirical studies of their operations are so scanty. Thus, it is not possible to present a definite appraisal of their

contribution to new investment and it is not possible to measure the cost of tax incentive measure against benefits received.

(b) It is criticized as being as ineffective and inefficient stimulus to investment especially in developing countries as it complicates the regular company or business tax legislation and tax shelters made available to taxpayer through all sorts of means is a veritable source of tax avoidance and/or evasion for a "smart" taxpayer who may take advantage of the yawning. Loopholes that may result there from.

(c) It has also been criticized on the ground that if a tax system, believes in the sanctity of endless provision of shelters, there will be no end to the erosion of the statutory tax base of such a tax system. According to Seyi Ojo, this is made worse by the government sacrificing its revenue base on the alter of political gains.

(d) It has been criticized that the resultant proliferation of tax holiday and the keen competition among developing countries especially in offering tax incentives for new incentives has to a great extent diluted its promotional value.

(e) The grant of tax incentive has been criticized because it is said to be disproportionate as the benefit derived there from firm to firm and as such, firms that are more profitable will likely enjoy more benefits than those with little or no profit has been countered by Seyi Ojo who said that if the most profitable business enjoys more benefits, there is nothing wrong as it should encourage other firms to work hard towards being profitable which will enhance the nation's wealth.

(f) It is also said that such large benefits too highly profitable business will result in a serious loss of revenue to the government which is almost short of revenue. It has in fact, been reported by Adetoun Phillips, that the cumulative effect of the incentives provided in Nigeria between 1958 and 1966 was a loss of revenue equivalent to four percent (4%) of the total revenue of government.

3.6 OTHER TAX PLANNING ISSUES

3.6.1 Thin Capitalisation

A company is said to be thinly capitalised when its capital is made up of a much greater proportion of debt than equity, i.e. its gearing, or leverage, is too high. This is perceived to create problems for two classes of people:

(a) Creditors bear the solvency risk of the company, which has to repay the bulk of its capital with interest; and
(b) Tax authorities, who are concerned about abuse by excessive interest deductions.

Credit risk
If the shareholders have introduced only a nominal amount of Paid-up share capital, then the company has lower financial reserves with which to meet its obligations. If all or most of the company's capital comes from debt, which (unlike equity) needs to be serviced, and ultimately repaid, it means that the providers of capital are ultimately competing with the company's trade creditors for the same capital resources.

At the risk of generalising, most traditionally common law countries do not tend to employ thin capitalisation rules generally in relation to raising and maintenance of capital. However, a number of civil law jurisdictions do.

However, in almost all jurisdictions there are certain types of regulated entity which require a certain amount, or a certain proportion, of paid-up share capital to be licensed to trade. The most common examples of this are banks and insurance companies. This is because if such companies were to fail and go into liquidation, the economic effect of such failures can lead to a domino effect, which can have catastrophic consequences for other businesses and, ultimately, regional economies.

Tax issues
Even where countries' corporate laws permit companies to be thinly capitalised, tax authorities in those countries will often limit the amount that a company can claim as a tax deduction on interest, particularly when it receives loans at non-commercial rates (e.g. from connected parties). However, some countries simply disallow interest deductions above a certain level from all sources when the company is considered to be too highly geared under applicable tax regulations.

Some tax authorities limit the applicability of thin capitalisation rules to corporate groups with foreign entities to avoid "tax leakage" to other jurisdictions. The United States "earnings stripping" rules are an example. Hong Kong protects tax revenue by prohibiting payers from claiming tax deductions for interest paid to foreign entities, thus eliminating the possibility of using thin capitalisation to shift income to a lower-tax jurisdiction.

3.6.2 Tax Haven

Introduction

A tax haven is a state, country or territory where certain taxes are levied at a low rate or not at all. Individuals or corporate entities can find it attractive to establish shell subsidiaries or move themselves to areas with reduced or nil taxation levels relative to typical international taxation. This creates a situation of tax competition among governments. Different jurisdictions tend to be havens for different types of taxes, and for different categories of people or companies. States that are sovereign or self-governing under international law have theoretically unlimited powers to enact tax laws affecting their territories, unless limited by previous international treaties.

Definitions

The Organisation for Economic Co-operation and Development (OECD) identifies three key factors in considering whether a jurisdiction is a tax haven:

(a) Nil or only nominal taxes. Tax havens impose nil or only nominal taxes (generally or in special circumstances) and offer themselves, or are perceived to offer themselves, as a place to be used by non-residents to escape high taxes in their country of residence.

(b) Protection of personal financial information. Tax havens typically have laws or administrative practices under which businesses and individuals can benefit from strict rules and other protections against scrutiny by foreign tax authorities. This prevents the transmittance of information about taxpayers who are benefiting from the low tax jurisdiction.

(c) Lack of transparency. A lack of transparency in the operation of the legislative, legal or administrative provisions is another factor used to identify tax havens. The OECD is concerned that laws should be applied openly and consistently, and that information needed by foreign tax authorities to determine a taxpayer's situation is available. Lack of transparency in one country can make it difficult, if not impossible, for other tax authorities to apply their laws effectively. 'Secret rulings', negotiated tax rates, or other practices that fail to apply the law openly and consistently are examples of a lack of transparency. Limited regulatory supervision or a government's lack of legal access to financial records are contributing factors.

Classification

Corporations, in order to achieve effective tax avoidance, use multiple types of tax havens. Three types of tax haven types form a Dutch Sandwich:

(a) Primary tax havens: the location where financial capital winds up. Subsidiary shell companies there have obtained rights to collect profits from corporate intellectual property (IP) by transfers from their parent.

(b) Semi-tax havens: locations that produce goods for sale primarily outside of their territorial boundaries and have flexible regulations to encourage job growth, such as free trade zones, territorial-only taxation, and similar inducements.

(c) Conduit tax havens: locations where income from sales, primarily made outside their boundaries, is collected, and then distributed. Semi-tax havens are reimbursed for actual product costs, perhaps with a commodity markup. The remaining profits are transferred to the primary tax haven, because it holds rights to profits due to the corporate IP. By matching outflow to income they do not retain capital and their role, while crucial, remains invisible.

Large multinational corporations may have dozen of such tax haven entities interacting with each other. Each haven can claim that it does not satisfy definitions that attempt to place all tax havens into a single class. Even increased transparency does not change the effectiveness of corporate tax avoidance.

Examples

Research has suggested that roughly 15% of the countries in the world are tax havens, that these countries tend to be small and affluent, and that better governed and regulated countries are more likely to become tax havens, and are more likely to be successful if they become tax havens.

Switzerland
Luxembourg—primarily a conduit tax haven
Other sovereign countries that have such low tax rates and lax regulation that they can be considered semi-tax havens are:
Ireland
Netherlands—primarily a conduit tax haven
Non-sovereign jurisdictions commonly labelled as tax havens include:
Jersey
Isle of Man
British Overseas Territory
Bermuda

British Virgin Islands
Cayman Islands
Delaware, United States
Puerto Rico (United States)

Methodology

At the risk of gross oversimplification, it can be said that the advantages of tax havens are viewed in the following four principal contexts:

(a) **Personal residency**

Since the early 20th century, wealthy individuals from high-tax jurisdictions have sought to relocate themselves in low-tax jurisdictions. In most countries in the world, residence is the primary basis of taxation. Almost no tax haven assesses any kind of capital gains tax, or inheritance tax. Individuals who are unable to return to a higher-tax country in which they used to reside for more than a few days a year are sometimes referred to as tax exiles.

(b) **Corporate Residency**

Corporate persons, in contrast to natural persons, can own subsidiary corporations in many countries. That allows them to take advantage of the variety of laws, regulations, and conventions in multiple countries, without overtly engaging in any questionable activities. Only in extreme cases will they move their formal corporate headquarters.

(c) **Asset holding**

Asset holding involves utilizing an offshore trust or offshore company, or a trust owning a company. The company or trust will be formed in one tax haven, and will usually be administered and resident in another. The function is to hold assets, which may consist of a portfolio of investments under management, trading companies or groups, physical assets such as real estate or valuable chattels. The essence of such arrangements is that by changing the ownership of the assets into an entity which is not tax resident in the high-tax jurisdiction, they cease to be taxable in that jurisdiction.

Regulation measures

To avoid tax competition, many high tax jurisdictions have enacted legislation to counter the tax sheltering potential of tax havens. Generally, such legislation tends to operate in one of five ways:

(i) Attributing the income and gains of the company or trust in the tax haven to a taxpayer in the high-tax jurisdiction on an arising

basis. Controlled Foreign Corporation legislation is an example of this.

(ii) Transfer pricing rules, standardization of which has been greatly helped by the promulgation of OECD guidelines.

(iii) Restrictions on deductibility, or imposition of a withholding tax when payments are made to offshore recipients.

(iv) Taxation of receipts from the entity in the tax haven, sometimes enhanced by notional interest to reflect the element of deferred payment. The EU withholding tax is probably the best example of this.

(v) Exit charges, or taxing of unrealized capital gains when an individual, trust or company emigrates.

However, many jurisdictions employ blunter rules. For example, in France securities regulations are such that it is not possible to have a public bond issue through a company incorporated in a tax haven.

Also becoming increasingly popular is "forced disclosure" of tax mitigation schemes. Broadly, these involve the revenue authorities compelling tax advisors to reveal details of the scheme, so that the loopholes can be closed during the following tax year, usually by one of the five methods indicated above.[59] Although not specifically aimed at tax havens, given that so many tax mitigation schemes involve the use of offshore structures, the effect is much the same.

Anti-avoidance came to prominence in 2010/2011 as nongovernmental organizations and politicians in the leading economies looked for ways of reducing tax avoidance, which plays a role in forcing unpopular cuts to social and military programs.[citation needed] The International Financial Centres Forum (IFC Forum) has asked for a balanced debate on the issue of tax avoidance and an understanding of the role that the tax neutrality of small international financial centres plays in the global economy.

Criticism

Tax havens have been criticized because they often result in the accumulation of idle cash which is expensive and inefficient for companies to repatriate. The tax shelter benefits result in a tax incidence disadvantaging the poor. Many tax havens are thought to have connections to fraud, money laundering and terrorism. While investigations of illegal tax haven abuse have been ongoing, there have

been few convictions. Lobbying pertaining to tax havens and associated transfer pricing has also been criticized.

Some politicians, have begun to stand up against the use of tax havens by large companies. She describes the act of avoiding tax as a threat to democracy. Accountants' opinions on the propriety of tax havens have been evolving, as have the opinions of their corporate users, governments, and politicians, although their use by Fortune 500 companies and others remains widespread. Reform proposals centering on the Big Four accountancy firms have been advanced. Some governments appear to be using computer spyware to scrutinize some corporations' finances.

3.6.3 Executives on Foreign Assignment

Income tax is levied on individuals who perform employment duties in Nigeria and those resident abroad, but who are employees of the Nigeria Government. An individual who is an employee of a non-resident entity is not liable to tax in Nigeria. If he/she spends less than 183 days (six months) in Nigeria in any 12 month period (one year) period, and if his/her remuneration is subject to tax in the country of residence. Where foreign-nationals are on assignment in Nigeria and will last for less than 183 days, taxes may not be applicable. However, the nature of the visa obtained may inadequately put the individual in a taxable positions. Most countries of the world depend on their residency rule for tax liability to attach, therefore Nigeria Executives on short term assignments are not likely to be subjected to foreign tax laws except for taxes like VAT and withholding tax.

3.6.4 Foreign Direct Investment

(a) Foreign Direct Investment are not in flows of investment to acquire a testing management interest (10% or more) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, and short-term capital as shown in the balance of payments. This series shows total net, that is, net FDI in the reporting economy to the rest of the world.

(b) There have been however some incentives that have been provided by the Federal Government to invest in Nigeria.

(c) In December 1989, Nigeria Enterprise Act permitted 100% foreign ownership in any new venture except those in banking, oil, insurance and mining

(d) In 1992, the Nigeria free Zone Act was passed establishing Nigerian Export Processing Zone Authority (NEPZA). Free Trade Zone (FTZ)

(e) Transferability of funds
Nigeria Enterprises Promotion Act provided that a foreign investor in an enterprise shall be guaranteed unconditional transferability of funds through an authorized dealer in freely convertible currency of dividend of profit.

3.6.5 Non-Tax Factors

Once an investor has determined that the business structure of his/her investments, the investor engages in identyfing a jurisdiction with the infrastructure that will optimally attain his/her objectives. Infrastructure presents tax and non-tax of the particular jurisdiction.

The tax regime that applies in a specific location is generally an important of a holding company and usually plays a role as far as a decision company should be established is concerned. However non-tax factors cannot be undermined as they are key to the success of the investment that is undertaken factors that affect the choice of location, in other words, locational determinants, will differ from one business to another, depending on the objectives of the investment.

The more important non tax factors include:
(a) Economic and political stability
(b) Adequate physical, business, accounting and legal infrastructure
(c) The absence (or limited presence) of bureaucratic obstacles
(d) Adequate communication channels
(e) Ability to negotiate profit freely
(f) Effective banking system
(g) The availability of an adequate dispute resolution mechanism

The social, economic and political stability and risk within different countries are major considerations in the decision-making especially where the need for the raising of finance is important. A factor that supplements the social, economic and political stability is the functionality of the country's legal system and rule of law. Thus, not only should the legal system be suitable for transacting but it should also be possible for legal subjects to enforce their legal rights. Alternative dispute resolution as a legal process is normally an expedient and cheap alternative to the often lengthy legal processes. Where available, it too should be reliable. The country's government should also respect the rule of law and ideally have an enshrined constitution that protects the rights of the country's subjects. As Olivier and Honiball observe:

... a combination of operational business activities with an intermediary holding company in a single legal structure could expose an operational company's assets and investments to commercial risks. Stable laws and

ease of compliance could assist in offsetting such risks. The commercial language of the host country is also important. It is important that the language used is the same as the language of the investor (or at least a common language such as English or French). The importance of this factor is illustrated by the loss of popularity of the Danish holding company structure due to the requirement that compliance and reporting documentation had to be in Danish. Linked to the prevailing commercial language, are reliable communication channels such as telecommunication, fax and email, without which the performance of various roles would be impaired.

Business deal with control and management (including investment management) and the discharging of such services requires a few highly skilled people in the areas of law, financing and financing structures, economics, accounting and auditing, most holding companies do not necessarily require large numbers of employees to be stationed in the host country.

3.7 CHAPTER REVIEW

This chapter deals with tax planning, tax avoidance as tax schemes that taxpayers could utilise to achieve tax savings. Such tax savings schemes are only allowed if obtained through legitimate exploitation of loopholes in tax laws. Tax evasion effected through fraud is subject to criminal prosecution and is subject to fines and/or imprisonment. This chapter also discusses communication with clients, relevant tax authorities and related parties.

Current issues about tax registration, self-assessment, e-payment, objections and tax queries procedures were equally discussed.

3.8 WORKED EXAMPLES QUESTIONS

3.8.1 Questions

(1) A taxpayer has been running his business under the name Chisco Enterprises for several years. A limited liability company (Outsourcing Enterprises Limited) in the same trade was desirous of expanding its own market share. It therefore decided to make an attractive offer to the proprietor of Malami Enterprises. The proprietor is keen to accept the offer because of its attractiveness.
The sale is scheduled to take place at a mutually agreed date. The following details relating to Malami Enterprises are made available.

	₦
Adjusted profit for year ended 30 September 2001	80,000
Adjusted profit for year ended 30 September 2002	240,000
Adjusted profit for year ended 30 September 2003	360,000

The estimated profits for the year to 30 September 2004
and, that for the period to 30 January 2005, have been

given as follows:

Year ended 30 September 2004	430,000
3 Months to 31 December 2004	60,000
1 Month to 31 January 2005	10,000

Required:
Advise the proprietor of Malami Enterprises on whether to dispose the business on 31 December 2004 or on 31 January 2005. Support your answer with relevant computations.

(2) Recently, the Federal Government through the Finance Minister announced increases in the capital base of all categories of insurance companies. Opinion is, however, divided on the appropriateness or otherwise of this policy directive.

You have been appointed as a consultant by Ultimate Risk Limited, a Nigerian insurance company, to guide it through the entire process of raising the necessary additional capital through the Nigerian Stock Exchange.

Required:
Advise the management of Ultimate Risk Limited on the tax implications of the issues listed below:

(a) The cost of increasing the authorised share capital with the Corporate Affairs Commission, Abuja.
(b) The cost of obtaining approval from regulatory authorities like, the Nigerian Stock Exchange, Securities & Exchange Commission and National Insurance Commission (NAICOM).
(c) Acquisition of another insurance company. Concern yourself only with the tax implications from the side of the acquired company.

(3) In June 2004, the Central Bank Governor introduced a major reform agenda in the banking industry. As part of the policy measure, banks in Nigeria were to increase their shareholders' funds to N25 billion by 31 December 2005. Since then, individual banks have taken some steps to meet this deadline. Some banks have signed Memorandum of Understanding (MOU) as a major plan in their consummating the proposed mergers and acquisitions. Some banks have gone to the capital market to raise additional funds by way of Private Placement and Initial Public Offers (IPO).

There is a proposed merger between five banks, some of which are quoted on the Nigeria Stock Exchange and others are unquoted. Due diligence has been embarked upon as part of the merging process. The Managing

Director of the proposed new bank has been named. The take-off date of the new bank has been slated for 31 May 2005.
In April 2005, you were appointed as a Consultant with a brief to do the following:

(i) Advise on the tax implications or tax issues involved before and after the merger.

(ii) Advise on any possible options open to them in the area of tax planning.

(iii) Advise on any possible tax incentives available to them.

Required:
Advise the parties with particular reference to:
(a) Tax issues.
(b) Tax implications on the merging banks and the new bank.
(c) Tax problems / practices avoid discussion of issues on personnel, accounting etc.

(4) With respect to Tax Planning, you are required to comment on each of the following:
(a) Bonus Issue and Dividend
(b) Employer using staff remuneration
(c) An investment of ₦3,200,000 in fixed deposit at a rate of 20% p. a against the same amount in a Treasury bill at a rate of 18$^1/_2$% p.a.
(d) Life Assurance Policy
(e) A company involved in manufacturing and exportation of agricultural plants.
(f) Roll over relief
(g) Use of leased assets.

3.8.2 Suggested Solutions

1. O/R Y/R 19 May 2006

The Proprietor
Malami Enterprises
Jibowu
Lagos.

Dear Sir,

RE : ADVICE ON APPROPRIATE DATE OF CESSATION
The above subject refers.

We wish to advise that on cessation of business, the tax authority has the right to assess the business either on actual year basis or on preceding year basis for the penultimate year. In practice, the tax authority will choose the higher of the two. For the final year, the assessable profit is the profit from 1st of January to the actual date of cessation.

From the above, it can be seen that when profit is accruing at a reducing rate towards the date of cessation, it is more tax efficient to delay cessation as long as possible and vice versa.
From the computations attached, the profit was reducing towards the date of cessation.

We, therefore, advise that the cessation be delayed till 31 January 2005.

Thank you and best regards.
Yours faithfully,
PAL Associates Limited

Fash Oni
Managing Consultant

Workings

(a) Computations assuming 31 December 2004 as date of Cessation

2003 the higher of :		₦
(i) 1/1/2003 - 31/12/2003		
($^9/_{12}$ x ₦360,000 + $^3/_{12}$ x ₦430,000)	=	377,500
(ii) 1/10/2001 - 30/9/2002	=	240,000

2004	1/1/2004 - 31/12/2004	
	($^9/_{12}$ x ₦430,000 + ₦60,000)	= 382,500

(b) Computations assuming 31 January 2005 as date of cessation

		₦
2003	1/10/2001 - 30/9/2002	= 240,000
2004 the higher of :		
	(i) 1/1/2004 - 31/12/2004	
	($^9/_{12}$ x ₦430,000 + ₦60,000)	=382,500
	or	
	(ii) 1/10/2002 - 30/9/2003	=360,000
2005	1/1/2005 - 31/12/2005	10,000

Summary of Assessable Profits

Tax year	**31/12/2004**	**31/1/2005**
	₦	₦
2003	377,500	240,000
2004	382,500	382,500
2005	NIL	10,000
Total	**760,000**	**632,500**

2. O/R Y/R Date

The Board of Directors
Ultimate Risk Limited
Lagos.

Gentlemen,

RE : THE TAX IMPLICATIONS OF MEETING THE NEW CAPITAL BASE FOR INSURANCE COMPANIES

We wish to thank you for our recent appointment as the Consultant in respect of the above subject.

We wish to advise that:

(a) There is need to increase the Authorised Share Capital from its present level to that stipulated by the recent policy directive. The relevant fees to be paid to the Corporate Affairs Commission, Abuja are of a capital nature. This, therefore, serves as a guide in treating the amount as a disallowable expense for tax purposes. This is the position of the tax law.

(b) The cost of obtaining approval from the relevant authorities like Securities Exchange Commission (SEC), Nigerian Stock Exchange (NSE) and National Insurance Commission (NAICOM) are also capital in nature. They will thus be treated as disallowable for tax purposes.

(c) In the case of an acquisition of another company, it is to be expected that the acquired company will cease to exist. This is the first tax implication for the acquired company.
The issues before acquisition of the company are as follows:
   (i) Find out the tax status of the company to be acquired. Have all returns been filed? Have all the taxes been paid?
   (ii) Check outstanding tax queries and determine the tax implications of any of them.
   (iii) Confirm that tax audit has been carried out on the acquired company.
   (iv) Obtain copy of the Company's Tax Clearance Certificate.
   (v) Ascertain all outstanding issues on VAT and resolve same.
   (vi) Ensure that Capital Gains Tax on any asset disposal are paid to the relevant tax authority.
   (vii) Check Withholding Tax files for outstanding issues and resolve same.

(viii) Confirm payment of adequate Stamp Duties to be sure there will not be any outstanding payments due to misstatement of Stamp Duties paid during previous increases.

(ix) Cessation rules will not apply to the acquired company as it is deemed to be continuing in business.

(x) No initial allowance will be granted on the assets.

(xi) The assets will be deemed to have been transferred to the acquiring company at tax written down values and therefore to be written off over the unexpired life of the assets.

We hope this report will be carefully considered by the Board in due course. Should you require further clarifications, please do not hesitate to contact us.

Thank you.

Yours faithfully,
for: A-Z Consultant

Peter Okolo
for: Managing Director

NOTE,

This is a question on the process, cost and tax implications of increase in (i) Capital base by Corporate insurance organisations and (ii) Acquisitions within the industry.

3. RE: MERGER OF FIVE BANKS EXAMINATION OF TAX ISSUES INVOLVED

We refer to your brief on the above subject and like to respond as follows:

(a) **Preamble**

A merger is a form of business combination whereby two or more companies come together to become one enlarged surviving company. There are various tax implications on the individual banks coming together as newly enlarged company.

The tax implications on merging companies depend on whether the merging banks are related and in the same group or whether they are not related or do not have common control as provided in Section 25 (9) of CITA 290 CAP 60 LFN 2004.

(b) **Tax Issues before merger**

It is important that comprehensive checks are carried out on the individual merging companies in the following areas:

(i) **Corporate Tax**

- Ascertain whether the companies have filed tax returns to date and that all taxes have been fully paid;
- Check outstanding tax queries to determine the tax implications of any of the pending issues;
- Confirm that tax audit has been carried out on the companies and that taxes resulting there from have been paid; and
- Obtain copies of the companies' Tax Clearance Certificates.

(ii) **Value Added Tax**

- Review the Value Added Tax compliance level of the banks to ensure that there are no outstanding liabilities; and
- Review the audited financial statements and compute the VAT liability on the Vatable non-interest incomes, to compare with VAT paid over the period.

(iii) **Capital Gains Tax**

- Ensure that Capital Gains tax on any asset disposed are duly paid to the relevant tax authority.

(iv) **Withholding Taxes (WHT)**

- Check the WHT files of the banks to ensure that withholding tax provisions have been complied with and that all tax queries and WHT audit / verification exercise have been resolved.

(v) **Stamp Duties**

- Where there is increase in the Share Capital of any of the banks, confirm payment of adequate stamp duty; and
- Also ensure that Stamp duties are paid on all sale agreements and other deserving documents.

(c) **Tax Issues after Merger**

Where there is a merger of two or more banks, the tax implications will depend on whether the merging banks are related or not.

(i) Where the merging banks are related with one bank having overriding control, according to Section 25 (9) of CITA; the following shall apply:

- The commencement and cessation rules shall not apply, as all the banks will be deemed to be continuing in business and assessed to tax on proceeding year basis;
- The assets of the merging banks will be deemed to have been transferred to the new bank at Tax written down values and therefore to be written off over the unexpired life of the assets;
- No Initial allowance will be granted on the assets; and
- One of the companies will be required to guarantee payment of any tax liability due and payable.

(ii) Where the merger is of non-related banks, the following may be applied by the tax authority:

- All the banks will be deemed to have ceased business and cessation rules will apply;
- The new bank will be deemed to have commenced business and commencement rules will apply;
- Initial and annual allowances will be granted on the purchase cost of the assets; and
- The buildings taken over (if any) by the new bank will be valued at their purchase cost or original cost whichever is lower. No initial allowance will be granted.

(d) **Possible Tax Planning Options**

(i) Merger consideration pay-off by shares are not liable to capital gains tax, as provided in Section 32A of the CGTA of 1990 CAP 42 LFN 2004. Therefore, where consideration is to be offered, it should be in shares.

(ii) Whether the merger is between related or unrelated companies, where the assets of the banks are taken over at market values, capital allowance will be claimed on the transferred value, as against the tax written down values, with the consent of the Federal Inland Revenue Service (FIRS).

(iii) Where the new bank is deemed to have commenced a new business, the taxpayer's option under Section 24 (3d) of CITA should be applied, where it is favourable to the company.

(iv) Where the new company is deemed to be continuing in business, any unrelieved loss of the individual banks can

be carried forward by the new banks.

(v) Where there is reinvestment of proceeds of sale of an asset, roll over relief can be claimed.

(e) **Possible Tax Incentives on Merger**

(i) Careful application of the commencement rule may result in tax savings;

(ii) The combined assets of the merging banks will result in higher capital allowances claimable; and

(iii) Unrelieved losses of the individual banks can be carried forward to be relieved from the income of the new bank if the tax authority grants the concession.

Please note that the consent of the Federal Inland Revenue Service must be obtained before finalising any merger arrangement, as specifically provided for in CITA 1990.

Should you require any further explanation or clarifications on the issue, please do not hesitate to contact the undersigned.

Yours faithfully,
for: XYZ Tax Consultants

Ojo Jacob
for: Managing Partner

4. Tax planning can be described as a conscious effort on the part of a potential taxpayer, to organise his or her financial transactions (Income and Expenditure) in such a way as to legitimately minimize his or her tax liability at every point in time.

(a) **Bonus Issue and Dividend**
An investor in a company shall prefer Scrip or Bonus issue to dividend payment because the latter will attract 10% Withholding tax deduction on the dividend receivable. Gains made on disposal of stocks and shares currently (since 1998) do not suffer Capital Gains Tax.

(b) **Employer using Staff Remuneration for Planning**
This occurs when an employer in a bid to minimise the tax liability of the employees reduces the basic salaries and any other monetised benefits in favour of Benefits in Kind. It should however be noted that, such Benefits in Kind like employers assets put to the employees use, will attract 5% of the acquisition cost, if known, or 5% of the market value of the assets at the time of acquisition.

Also a Company may decide to pay a lump sum to an employee, and choose to regard such amount as compensation for loss of office which attracts no tax at all.

(c) The investment of ₦3,200,000 in a Fixed Deposit account and Treasury Bill

	FIXED DEPOSIT	TREASURY BILL
	₦	₦
Principal	3,200,000	3,200,000
Interest Rate	X 0.2	X 0.185
Interest	640,000	592,000
Less: Withholding		
tax at 10%	64,000	NIL
Net Income	576,000	592,000

Income savings resulting from taking the option of Treasury bill is:

₦592,000 - ₦576,000 = ₦16,000

The investor has therefore saved ₦16,000 in income, by avoiding the Withholding tax due under the Fixed Deposit option, having decided to invest in treasury bill.

(d) **Life Assurance Allowance**

An employee can minimise his tax liability by taking a Life Assurance Policy, as actual premium payment in the preceding year is allowed for tax purposes provided there is evidence that the policy is in his name, or in respect of a contract for a deferred annuity on his own life or the life of his spouse and evidence of payment of the premium in form of policy certificate. Also gains on disposal of interest under a life policy are exempted from Capital Gains Tax.

(e) A company involved in manufacturing and exporting agricultural equipment instead of trading in such equipment, would enjoy the following tax incentives:

(i) Capital allowances are not restricted for agro-allied business or Agricultural Equipment Manufacturing Companies. Losses incurred can be carried forward indefinitely.

(ii) If the Company in question obtained a loan for the purpose of the export business, the interest income by the bank is exempted from tax depending on moratorium and repayment period. The interest expenses are treated as

allowable charges against income. Dividends received from companies in this business are exempted from tax.

(iii) The Company can be granted Pioneer Status, if exports accounts for at least 50% of the annual turnover.

(iv) Companies with turnover of less than ₦1 million will be taxed at 20% in the first five years.

(f) **Roll - over Relief**

A company may use the proceeds of sale of one asset to buy another asset of the same category and use for the same purpose as the one sold in order to escape paying Capital Gains Tax that would have accrued on the disposal of the initial asset. Roll over relief is also granted where compensation received for loss or destruction of an asset is re-invested in replacement within three years.

(g) **Use of Leased Assets**

This is used as a means of financing purchases of fixed assets and for tax planning. There are two types, namely finance and operating lease. The advantages accruing to a company from applying either type of financing include:

Under Finance Lease

(i) The lessee is entitled to claim Capital Allowances.

(ii) In a sale and lease back arrangement, the lessee also claims Capital Allowances.

(iii) Instalmental payments of principal plus interest made by the lessee company are allowable expenses.

Under Operating Lease

(i) The lessor will claim Capital Allowance.

(ii) Balancing charge / allowance are claimable in the events of disposal.

CHAPTER 4

Tax Audit and Investigation

Contents

1. Purpose
2. Introduction
3. Tax Audits
4. The Tax Audit Branch
5. Types of Tax Audit
6. The Tax Audit Process
7. Types of Audit Exercise
8. Audit Programme
9. Tax Investigations
10. Stages of Tax Investigation
11. Investigation/Intelligence Division
12. Civil Investigations Unit
13. Criminal Investigation Unit
14. Intelligence Unit
15. Assessment of Investigation/Intelligence Division
16. Chapter Review
17. Worked Examples

4

TAX AUDIT AND INVESTIGATION

4.0 PURPOSE

After studying this chapter, readers should be able to know:

(a) the objectives of tax audit;

(b) how to conduct a tax audit;

(c) the basis of the power of the Revenue Service to audit;

(d) the reasons for tax investigation; and

(e) how to conduct a tax investigation.

4.1 INTRODUCTION

An Audit

An audit is an examination usually by an independent person, of a set of the accounting books, records, documents, etc, from which a set of financial statements 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.

Specialised Audits

Specialised audits are normally involved whenever special attention is needed on a special issue that are not part of the objectives of statutory audits. When a specialised 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.

4.2 TAX AUDITS

Tax audits are 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 relevant tax authority to carry out tax audit. The subsection states: "Nothing in the foregoing 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 returns filed by taxpayers through a tax audit process. The tax audit exercise essentially is meant to enable the tax 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.

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 determining 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:

(i) Provision of an avenue to educate taxpayers on various provisions of the tax law;

(ii) Discourage tax evasion;

(iii) Detect and correct accounting and/or arithmetical errors in tax returns;

(iv) Provide feedback to the management on various provisions of the law and recommend possible changes;

(v) Identify cases involving tax fraud and recommend them for investigation;

(v) Forestall taxable persons' failure to render tax returns;

(vii) Forestall taxable persons' rendering incomplete or inaccurate returns; and

(viii) To encourage voluntary compliance which is one of the strong reasons in support of the self-assessment scheme.

Tax audit is usually conducted by a group of experienced support staff of the Revenue authority.

4.4 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 the reform, each of the Integrated Tax Offices (ITO's), is expected to have its own resident Tax Audit Unit.

4.5 TYPES OF TAX AUDIT

The two types of tax audit are:

(a) Desk Audit; and
(b) Field Audit.

Desk Audit

As soon as a tax return is received in the tax 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 carrying 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 audit whenever additional information or documentary evidence is required to satisfy the Inspector of Taxes carrying out the desk audit.

Field Audit

A field audit is more elaborate and comprehensive than a desk audit. It is usually carried out outside the tax 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.

4.6 THE TAX AUDIT PROCESS

4.6.1 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) **Area Tax Controllers:** Desk officers through their area tax controllers (ATC), recommend cases for tax audit. The ATC 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.

4.6.2 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.

4.6.3 Selection of Taxpayer to Be Audited

The guidelines and criteria for the 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 the last audit of the taxpayer.

(b) Taxpayers 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 centralising an erstwhile decentralised operation.
(q) Information from intelligence unit of the tax authority.
(r) Directive from higher government authority.

4.6.4 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 the taxpayer, analytical review of taxpayer's performances using ratio analysis and highlighting risk areas for the audit exercise.

This review will also lead to the determination of the appropriate 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 officers 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 grouping 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 checklists 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 businesses 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 (authorised 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) Statement of Financial Position and Statement of Comprehensive Income;
- (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 following, 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) Inventory turnover
- (iv) Working Capital turnover
- (v) Asset turnover

(c) **Equity Position and Coverage**

These are ratios that measure the 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 on Owners equity

(iii) Ratio of Tax already assessed 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) Post dating sales (what happens to the related costs when income is post dated); and

(f) Omission of income.

Proper interpretation of these ratios will lead to determination of the risk areas for tax audit focus.

4.6.5 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 tax officials that will carry out the audit.

Members of the audit team are expected to carry their identity cards. The identity cards should only be shown on request by the taxpayers but should neither be taken away from the auditors nor allowed to be photocopied.

4.6.6 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) Familiarisation with the company's accounting and operational systems which include, but not limited to, the following:

- Whether the company operates manual or computerised 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 therefrom

(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 and 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.

4.6.7 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.

4.6.8 Interim Audit Reports

Preliminary Reports: 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 Reports: After the field audit, but before the conclusion of the 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.

4.6.9 Post Audit Review by Regional/Headquarters Auditors 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.

4.6.10 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 Tax Appeal Tribune

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.

4.6.11 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 report will state the findings and details of tax liabilities, if any. An audit report should always be completed with the auditors' recommendations. 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 analysed in tabular form under various taxes (CIT, 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 defence in case of an appeal to the Tax Appeal Tribunal, in which case, a copy of the report will be sent to the Legal Adviser for follow-up.

4.7 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 the 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 carry out audit to achieve a specified purpose. Such instances include:

(i) Verification of taxpayers' 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.

4.7.1 Technical Procedures

Technical procedures refer to the process of carrying out tax audit. It involves planning, organising 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 technicality 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) **Circularisation letters:** These may be sent to identified 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 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) **Objections:** Objections to the additional assessment could be raised either immediately after the letter of intent has been received by the taxpayer or after the 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, if 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.

4.8 AUDIT PROGRAMME

This is a schedule of audit work expected to be performed on each item of the accounts such as income/turnover, expenditure, 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 staff 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) Ensures 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 bringing 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.

4.9 TAX INVESTIGATIONS

Investigations, as distinct from tax audits, are called for when there are problems in, for example, an organisation either affecting the whole or particular segment of the organisation. Such could be required when a large fraud is suspected or when evidence of mismanagement abound and an interested party requires that the effect on the enterprise be quantified for management decision-making purposes.

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 enforcers, 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 a business premises to facilitate their work and obtain all the documents needed to substantiate the evidence of tax evasion and fraud.

4.10 STAGES OF TAX INVESTIGATION

Actual investigation of tax cases involve 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 and have the suspect arrested if necessary. At this stage, any individual may be invited for investigation. Also, thorough searches 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 insane.

4.11 INVESTIGATION/INTELLIGENCE DIVISION

The Investigation/Intelligence Division 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, hence ensuring tax compliance;

(d) Set up procedures for case referrals from tax offices;

(e) Set up 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) Develop and implement appropriate training program for field officers on how to conduct investigation/intelligence work, preparing a case for court, computer searches for evidence gathering and data recovery; etc.;

(j) Partner with other experienced tax jurisdictions in the area of information sharing, latest developments in taxation, including emerging areas of tax fraud, computer searches and data recovery;

(k) Liaise with the various regulatory agencies on issues of tax violations;

(l) Provide law enforcement agencies with information sufficient to prosecute violators;

(m) Provide management with an update of cases prosecuted;

(n) Develop and maintain a system of records to track and report on cases, their progress and results;

(o) Recommend amendments to tax laws in order to plug all areas of tax leakages; and

(p) Budget and plan for financial, material and human resource requirements of the division.

4.12 CIVIL INVESTIGATIONS UNIT

The activities of this unit revolve around the following:

(a) Investigate tax avoidance schemes
Examples are:
   (i) Artificial transactions – Section 18 of CITA that is any transaction carried out primarily to obtain tax benefits (reduction or avoidance or deferral of tax or increase in refund of tax etc).
   (ii) Creating an offshore company for purposes of reducing tax payable. For example, instead of having the Nigeria company buy direct from a foreign supplier, a related offshore company is set up in a tax haven country to do this and will in turn sell the product at a higher amount to the Nigeria company thereby diverting profits offshore. Another example would be when a profitable division is moved offshore. The key is to determine if in fact it is operating off shore.
   (iii) Treaty shopping. This involves shopping for the best tax rates offered by treaty countries and then carry out transaction in such a manner to take advantage of those tax rates.
   (iv) Back to back loans (to avoid Withholding Tax (WHT)).
   (v) Allege purchase of foreign assets at inflated amounts, which results in excess capital allowances claim.

(vi) 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.

4.13 CRIMINAL INVESTIGATION UNIT

The criminal investigation Unit is responsible to:

(a) Investigate, penalise and recommend prosecution in cases of tax evasion. With tax evasion, you have fraud with “mens rea”, 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) The use of artificial transactions;

(vii) Complex management structure and associated entities that would result in tax evasion;

(viii) Non filing of tax returns or filing of incorrect returns; and

(ix) 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) Analyse and evaluate evidence 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.

4.14 INTELLIGENCE UNIT

The main function of this unit will be to gather and analyse 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 taxpayers, 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.

4.15 ASSESSMENT OF INVESTIGATION/INTELLIGENCE DIVISION

The perceived strengths and weaknesses of the Investigation/Intelligence Division are:

(a) **Strengths**

(i) Top 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) Conflicts between Tax Audit Section in tax offices and civil investigation unit.

(iv) Delays through lack of cooperation from taxpayers in the provision of necessary documents and records.

(v) Inadequate funding due to budgetary constraints.

(vi) Inadequate experience in criminal investigation.

(vii) Reliance on external bodies such as the Nigerian Police, Economic and Financial Crimes Commission, etc.

(viii) Inadequate Infrastructure - Computers and Equipment to perform necessary duties and unstable power supply.

4.16 CHAPTER REVIEW

This chapter defines tax audits and investigations and explains its objectives. It also describes the two types of tax audits and explains the process of carrying out a tax audit especially under the pre-self assessment period and under the current self-assessment regime.

There is explanation on preliminary matters to be addressed before an audit is commenced, what to do during an audit and what needs to be done in concluding an audit, both in the taxpayer's office and in the tax auditors' office.

These include the preparation of audit checklist, preliminary meeting between the taxpayer's representatives and the tax auditors, analytical review of tax

returns, post audit meetings and final audit report as well as raising of additional assessment, if any, to conclude a tax audit.

However, in the case of tax investigation, an intelligence unit of the tax authority is involved in sourcing for tax information as regards incomes from all sources received by, or paid to a named taxpayer.

4.17 WORKED EXAMPLES

4.17.1 Questions

1. DYO Nigeria Plc is a manufacturer of home appliances. The company has been operating as an indigenous business for the past fifteen years. The company has branches in the six geographical zones of Nigeria and it is still planning to expand its business beyond Nigerian shores.

   The operating efficiency of the company appears sufficiently sound and would be able to overcome any competitive activity. The company is quoted on the stock exchange, hence it is easily seen how positive its share trend has been.

   The company has efficient staffing policy, hence the staff members are professionals in their individual areas of discipline.

   In the last three years, the tax office has been having a running battle on the tax returns under self assessment system being forwarded to the tax authorities. In the last two years, tax office insisted that the company be assessed on best of judgement. This decision did not go down well with the Managing Director of the Company. Series of meetings were held between the company and the tax authority but without any success.

   With the breakdown of communication between the two parties, the tax office wrote to the company that a team of tax investigator were on their way to the company and that they be given free access to the company's tax related matters.

   The Managing Director now feels that he would not like to involve any party in the problem existing on tax matters and that he would like to know if tax auditors should be involved instead of investigators.

   Required:
   As a consultant to the company, explain the following:
   (a) (i) Tax Audit
       (ii) Checklist in tax audit
       (iii) Tax audit report
       (iv) Compare tax investigators with tax auditors

(b) Discuss the stages involved in tax investigation
(c) What can lead to the termination of a tax investigation?

2. As a consequence of the cashflow problems experienced by most state governments in Nigeria, most of them have secured the services of tax consultants to carry out back duty and tax investigations. This has increased the returns into the coffers of the various state governments just as it has necessitated filing of notices of appeal and appearances before the Tax Appeal Tribunal.

Required:
Explain the following:
(a) Back duty and tax investigation
(b) Investigatory power
(c) Search and seizure
(d) Appeals
(e) Notices of appeal
(f) Hearing of appeal
(g) Appeal against the decision of Tax Appeal Tribunal
(h) When an assessment is final and conclusive.

3. List the stages in a typical tax audit process.

4. "Tax audit is conducted for the purpose of ensuring that a taxpayer has conducted his affairs in accordance with the tax laws and practice".

Required:
Explain the following regarding the tax audit of the Revenue:
(a) Objectives of a tax audit
(b) Selection of tax payers for audit.

4.17.2 Suggested Solutions

1 (a) (i) **TAX AUDIT**
Tax audit is the examination carried out by tax officials on the accounting books, records, documents and tax returns filed by a company with a view to determining the level of compliance with the provisions of the tax laws.

(ii) **TAX AUDIT CHECKLIST**
This is the comprehensive list of the documents and information required in carrying on the audit. It ensures that the exercise is carried out in a systematic manner.

(iii) **TAX AUDIT REPORT**

This is the report issued by the tax officials on the audit exercise carried out on a company. The report should state the period covered by the audit, the scope of work done, findings and the additional tax liability established.

(iv) **TAX INVESTIGATORS/TAX AUDITORS**

Tax investigation aims to unearth fraud no matter how long and to secure evidential materials for possible prosecution of tax evasion or tax fraud in the law court. Investigators have a greater authority than the tax auditors because they can seal up a business premises in order to facilitate their work and obtain all the documents needed to substantiate the existence of tax evasion and fraud.

(b) **STAGES OF TAX INVESTIGATION**

(i) **Surveillance or Pre-investigation activities**

This involves checking and cross-checking of information and documentation on the purported tax fraud. It involves discrete analysis of data, reports and complaints.

(ii) **Evidential Audit or Investigation**

At this stage, investigators move into the business premises of the accused party, conduct indepth tax audit, tax audit, take charge of any available evidential materials, secure a warrant of arrest (if necessary) and lock up the suspect. At this stage, any individual can be invited for interrogation.

(iii) **Case Preparation**

This involves the collection of witnesses, the interrogation of suspects and a careful examination and analysis of seized documents. At this stage, the case can be stopped if the evidence is weak.

(iv) **Arraignment**

At this stage, it means that the case has gone to court for criminal prosecution. Therefore, the court process will start until the case is concluded and judgement passed.

(c) **TERMINATION OF INVESTIGATION**

An investigation of a criminal tax fraud or tax evasion can be terminated at any stage based on the following conditions:

(i) Insufficient evidence;
(ii) Criminality is not involved. This may be where tax avoidance is mistaken for tax evasion; and
(iii) If the suspect dies or becomes medically or legally insane.

2. (a) Back-duty assessment will arise on a tax audit exercise where the relevant tax authority has reviewed the underlying records of a taxpayer to confirm that the records agree with the returns that was earlier on-field. Any difference observed between the original returns and the underlying records form the basis of an additional assessment. Such additional assessments may become the subject of the objection and appeal procedures. Meanwhile, such back-duty work is limited to six years before the year of the audit.

On the other hand, an investigation is a more rigorous exercise which has no limit for the examination. Here, it may be triggered by some criminal activities such as outright evasion of tax. It will usually involve the use of law enforcement agents and the offenders may be charged to court for criminal activities.

(b) **Investigatory power**

(i) The Service shall employ Special Purpose Tax Officer to assist any relevant law enforcement agency in the investigation of any offence under the tax laws:

(ii) The Service shall have the power to investigate or cause investigation to be concluded to ascertain any violation of any tax law whether or not such violation has been reported to the service;

(iii) In conducting any investigation under b) above, the Service may cause investigation to be conducted into the properties of any taxable person if it appears to the Service that the lifestyle of the person and extent of the properties are not justified by the source of income;

(iv) Where any investigation reveals that the commission of any offence or an attempt to commit any offence, the Service shall undertake the prosecution of the offences.

(c) **Search and seizure**

Where the tax authority has a reasonable ground to suspect that an offence involving any form of total or partial non-disclosure of information or any irregularity or offence in connection with tax has been committed or can be found on the premises, registered office or any other office or place of management of the taxpayer or in his residence or the residence of its principal officers, agents, or representatives, the tax authority may authorize any of its officers to enter, if necessary by force, such locations at any time from the date of such authorization and conduct a search.

The authority to enter and search must be made in the prescribed form in the sixth schedule of the Act.

Upon entering the premises, the officer may seize and remove anything whatsoever found therein which he has reasonable cause to believe may be required for the purpose of arriving at a fair and correct tax chargeable on the taxpayer or as evidence for the purpose of proceedings in respect of such an offence.

An officer authorized to carry out any such search and seizure may execute any warrant by calling to his assistance any police officer and it shall be the duty of the police officer to aid and assist him.

(d) **Appeals**

A taxpayer may appeal against the decision of either the tax authority or the court where it is not satisfied. Such appeals must be lodged in writing and not later than 30 days after the receipt of the Notice of refusal to amend or the receipt of the judgement of the court.

(e) **Notices of Appeal**

The Notices of appeal must be written, contain the grounds of appeal and must be lodged not later than 30 days after the receipt of the Notice of Refusal to Amend or judgement of the court.

The Notice of appeal must contain certain basic information such as the name of the taxpayer; the tax file number; the relevant year of assessment; the amount of taxable profit; the amount of assessment; the date the Notice of refusal to amend or judgement of the court was received and the ground of appeal.

(f) **Hearing of Appeal**

The hearing of the appeal before the Tax Appeal Tribunal is usually made in public. Sometimes, the hearing will involve the taxpayer and the tax authority being represented to make their case. Each part is allowed the use of its auditors, tax consultants and legal advisers. The decision of the Tax Appeal Tribunal is usually under the hands of the chairman.

(g) **Appeal against the decision of the Tax Appeal Tribunal**

Once the Appeal Commissioner have delivered their judgement, an appeal may be lodged to the High court within 30 days of the receipt of the judgement. The appeal must be written and must be written and must show the grounds upon which the appeal is being made.

(h) **When an assessment is final and conclusive**

An assessment becomes final and conclusive where no valid objection or appeal has been lodged within the time limit. It is also applicable where an assessment as made or agreed to, revised or determined on appeal has not been the subject of a further appeal within the time allowed.

3. **Stages in Tax Audit Process include:**
   (a) Selection of the taxpayer to be audited;
   (b) Preliminary review of the taxpayer's file;
   (c) Notification of taxpayer;
   (d) Pre-audit meeting;
   (e) Field work;
   (f) Post audit meeting;
   (g) Interim audit report;
   (h) Post audit review by regional/headquarters' audit unit;
   (i) Reconciliation meetings; and
   (j) Final Audit Report.

4. (a) The objectives of a tax audit are to enable the tax auditors determine whether or not:

   (i) Adequate accounting books and records exist for the purpose of determining the taxable profits or loss of the taxpayer and consequently the tax payable;

   (ii) The tax computations submitted to the tax authority by the taxpayer agree with the underlying records; and

   (iii) All applicable tax legislations have been complied with.

   (iv) Provision of an avenue to educate taxpayers on various provisions of the tax law;

   (v) Discourage tax evasion;

   (vi) Detect and correct accounting and/or arithmetical errors in tax returns;

   (vii) Provide feedback to the management on various provisions of the law and recommend possible changes;

   (viii) Identify cases involving tax fraud and recommend them for investigation;

   (ix) Forestall taxable persons' failure to render tax returns;

   (x) Forestall taxable persons' rendering incomplete or inaccurate returns; and

   (xi) To encourage voluntary compliance which is one of the strong reasons in support of the self-assessment scheme.

   Tax audit is usually conducted by a group of experienced support staff of the Revenue.

(b) The guidelines and criteria for the 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:

(i) Self-assessment taxpayers – at least two years since the last audit of the taxpayer.

(ii) Taxpayers with refund claims – especially arising from excess withholding tax credits and, or other named reasons.

(iii) Taxpayers with nil returns or continuous loss situation.

(iv) Taxpayers with very low adequacy ratios.

(v) Based on routine industry checks or sectorial audit (project audit).

(vi) Based on lead information received from Intelligence or other FIRS departments or external sources.

(vii) Transfer pricing arrangements.

(viii) Tax planning schemes.

(ix) Claims under Double Taxation Agreement (DTA).

(x) Secondary files – relationship with another taxpayer by way of holding, subsidiary, associated or related companies, could be criteria for selecting companies for audit.

(xi) Industrial group's compliance evaluation and profitability comparison.

(xii) Verification of poor or extraordinary performance.

(xiii) Referrals resulting from desk examinations.

(xiv) Information resulting from examination, audit and investigation of other taxpayers.

(xv) Random sampling.

(xvi) Firms making unusual requests or taking extraordinary decisions such as centralising an erstwhile decentralised operation.

(xvii) Information from intelligence unit of the tax authority.

(xviii) Directive from higher government authority.

CHAPTER 5

Capital Gains Tax

Contents

1. Purpose
2. Nature and Objectives of Capital Gains Tax
3. Administration and Objectives of Capital Gains Tax
4. Allowable and Disallowable Expenditure
5. Rate
6. Computation of Chargeable Gains
7. Exemptions from Capital Gains Tax
8. Disposable and Acquisition of Assets
9. Reliefs
10. Offences and Penalties
11. Other Matters
12. Chapter Review
13. Worked Examples

5

CAPITAL GAINS TAX

5.0 PURPOSE

After studying this chapter, readers should be able to:

(a) know how Capital Gains Tax Act is administered;

(b) understand the nature and objectives of Capital Gains Tax;

(c) understand the principle of allowable and disallowable expenditure as applicable to Capital Gains Tax;

(d) know the chargeable gains that are exempted from Capital Gains Tax;

(e) understand all the Capital Gains Tax issues involved in acquisition and disposals of assets;

(f) know the reliefs available in Capital Gains Tax; and

(g) be able to prepare Capital Gains Tax computations in accordance with the provisions of the Capital Gains Tax Act CAP C1 LFN 2004.

5.1 NATURE AND OBJECTIVES OF CAPITAL GAINS TAX

In the usual income tax computations, profits or losses on disposal of fixed assets are excluded by means of adjustments to the relevant accounting results. At the same time, balancing adjustment would be made in the capital allowances computation in respect of the difference between the proceeds of disposal and the 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 charge would be restricted to the amount of capital allowances previously granted. This will be the difference between the cost of acquisition and the 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 law and practice, all transactions of capital nature are excluded from income tax. In view of the fact that the surplus referred to is a capital receipt, it cannot be included in gains or profits for income tax purposes. However, such capital gains are subject to Capital Gains Tax (CGT) under the Capital Gains Tax Act (CGTA).

The Capital Gains Tax Act enacted in 1967, came into effect from the 1967/68 assessment year. In addition to the necessity to charge capital gains to tax as

illustrated above, the Act could also have been introduced to produce an additional source of revenue to Government to finance Nigeria's civil war.

The principal Act together with all amendments thereto has been re-enacted as Capital Gains Tax Act CAP C1 of the Laws of the Federation of Nigeria (LFN) 2004 (as amended).

5.2 ADMINISTRATION OF CAPITAL GAINS TAX

The management of the Capital Gains Tax Act with respect to corporate bodies, individuals resident in the Federal Capital Territory (FCT) and Non-resident Individuals (Individuals outside Nigeria), is placed under the administration of the Federal Inland Revenue Service. This is with regards to returns, assessments, appeals, collections, recovery and repayments, offences and penalties as well as litigations.

The management of the Act with respect to individuals (except Non-residents), is placed under the administration of the States' Board of Internal Revenue.

Certain provisions of the "Income Tax Acts" (detailed in a schedule attached to the Capital Gains Tax Act) shall apply in relation to Capital Gains tax as they apply in relation to income tax chargeable under those Acts subject to any necessary modifications – Section 43(1)

Appeals against any assessment to Capital Gains Tax (CGT) shall be made in accordance with Section 54 of CITA or Section 53 of the PITA as the case may be, to the Tax Appeal Tribunal established under the Companies Income Tax Act. Section 43(2) of CITA.

CAPITAL GAINS

Capital Gains may be defined as gains arising from increases in the market value of capital assets, to a corporate body or person who does not habitually offer them for sale, and in whose hands they do not constitute stock-in-trade.

It is the difference between the consideration accruing and sums excluded from the consideration, being cost and ancillary costs of disposal of a capital asset.

One guiding principle is to examine, the purpose for which an asset is bought and / or sold. Where an asset is acquired and / or kept for use or as an investment, proceeds on the disposal of any such asset shall be treated as a capital receipt and any gain thereon will be regarded as a Capital Gain.

On the other hand, where fixed assets are kept and sold regularly for gains (profits), such disposal proceeds shall be treated as normal income receipts and taxed under the Personal Income Tax Act P8 LFN 2004 (as amended) or Companies Income Tax Act CAP C21 LFN 2004 (as amended).

CGT IMPOSITION

The tax is imposed on gains arising out of the ownership of a capital asset changing hands, either by exchange, transfer, sales or gift.
The Act as it is presently, is silent on gains arising from the appreciation in value of an asset, which has not changed hands over time.
Capital Gains Tax is chargeable on the total amount of the chargeable gains arising after deducting allowable expenses on the disposal of Chargeable assets, in a year of assessment.

Year of Assessment

A year of assessment in relation to Capital Gains Tax means, a year beginning with 1 January and ending with 31 December in the same calendar year with effect from 1969.

5.3 ALLOWABLE AND DISALLOWABLE EXPENDITURE

Deductions allowable (Section 14)

(a) Cost of acquisition or purchase price, including all costs incidental to the purchase.
(b) Improvement costs wholly, reasonably, exclusively and necessarily incurred.
(c) Cost wholly, reasonably, exclusively, and necessarily incurred in establishing, preserving or defending the owner's title to or a right over the asset.
(d) Incidental costs of disposal.

These include:

(a) Fees, commissions or remuneration paid for professional services of surveyor or valuer; auctioneer, accountant: agent and or legal adviser;
(b) Cost of transfer or conveyance (including Stamp Duties);
(c) Advertisement cost to find a seller/buyer; and
(d) Cost reasonably incurred to make any valuation or apportionment required for the purpose of computing the capital gains including expenses in ascertaining market value where required.

Disallowable Expenditure

Sums allowable as a deduction in computing the profits or gains or losses of a trade for income tax purposes are not allowable deduction under Section 14 above (Section 15).

Insurance premiums on the asset are not allowable – Section 16.

5.4 RATE

Capital Gains Tax (CGT) is chargeable at 10% on capital gains arising from disposal of assets (20% applied up to 31/12/95).

5.5 COMPUTATION OF CHARGEABLE GAINS

Gains Chargeable

Section 3, CGT Act defined chargeable assets as meaning all forms of property, whether situated in Nigeria or not and including:

(a) Options, debts and incorporeal property generally;

(b) Any currency other than Nigerian currency; and

(c) Any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired;

(d) Stock and shares of every description (excluded from chargeable assets with effect from 1/1/98).

In respect of assets outside Nigeria and

(i) Disposed by non-resident individual, or

(ii) Trustee of any trust or settlement, or

(iii) A company whose activities are managed and controlled outside Nigeria

CGT is chargeable on that part of the gains (if any) received or brought into Nigeria when they are so dealt with (Section 4). This is what is termed 'remittance basis'. The amount of the gains chargeable is dependent on the whole or part which is remitted to Nigeria. If there is no remittance to Nigeria, there is no liability to Capital Gains Tax in respect of the disposals of those fixed assets.

Capital loss on disposal of any asset is not deductible from capital gains on disposal of any other asset even if both are of the same type (Section 5).

5.6 EXEMPTIONS FROM CAPITAL GAINS TAX

The following are exempt chargeable gains:

(a) Gains accruing to:
- (i) An ecclesiastical, charitable or educational institution of a public character;
- (ii) Any statutory or registered friendly society;
- (iii) Any cooperative society registered under the Cooperative Societies Law of any State; and
- (iv) Any Trade Union registered under the Trade Unions Act.

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 and the gain is applied purely for the purpose of the institution or society as the case may be (Section 27(1).

(b) Gains accruing to any Local Government Council (Section 28(1).

(c) Gains accruing to any company, being a purchasing authority established by or under any law in Nigeria, empowered to acquire any commodity in Nigeria for export from Nigeria; or
Gains accruing to any corporation established by or under any law for the purpose of fostering the economic development of any part of Nigeria in so far as the gains are not derived from the disposal of any assets acquired by the corporation in connection with any trade or business carried on by it or from the disposal of any share or other interest possessed by the corporation in a trade or business carried on by some person or authority (Section 28(2).

(d) Gains accruing on disposal of investments held as part of any superannuation fund or other statutory retirement benefits scheme to the same extent as income derived from the assets would be exempt under Section 20 of PITA (Section 29.1).
Disposal of a right to, or any part of any sum payable out of any superannuation fund shall also not be chargeable (Section 29.2)
"Superannuation Fund" means a pension, provident or other retirement benefits fund, society or scheme approved by the Joint Tax Revenue Service under Section 21(1)(g) of PITA.

(e) Gains accruing on disposal by any person of a decoration awarded for valour or gallant conduct which he acquires otherwise than for consideration in money or money's worth (Section 30).

(f) Gains accruing from a disposal of Nigerian Government Securities (Section 31)
Nigerian Government Securities include Nigeria treasury bonds, savings certificates and premium bonds issued under the Savings Bonds and Certificates Act.

(g) Gains accruing on disposal of land compulsorily acquired by an authority having and exercising such powers (Section 9).

(h) Gains accruing in connection with the disposal of an interest in or the right under any policy of assurance or contract for a deferred annuity on the life of any person (Section 33).

Some of the other exemptions and relief provisions in the Act are as follows:

(i) Section 35 exempts sums obtained by way of compensation or damages for any wrong or injury suffered by an individual to his person or in his profession or vocation. This includes wrong or injury for libel, slander or enticement. Sums obtained by way of compensation for loss of office exceeding 10,000 in any year of assessment is however chargeable.

(ii) Section 36 exempts gains accruing on disposal of a dwelling house (with a maximum land area of up to one acre or such larger area as the Revenue Service may determine) which has been the individual's only or main residence throughout the period of ownership up to the time of disposal or up to the last twelve months before the date of disposal.

So far as it is necessary for the purposes of this Section to determine which of two or more residences is an individual's main residence for any period:

- The individual may conclude that question by notice in writing to the Revenue Service given within two years from the beginning of that period. This can be varied by a further notice in writing to the Revenue Service as respects any period beginning not earlier than two years before the giving of the further notice, and
- The question shall be concluded by the determination of the Revenue Service. The individual may appeal to the Appeal Commissioners against that determination within thirty days of service of the notice by the Revenue Service.

(iii) A gain accruing on disposal of tangible and movable assets shall not be chargeable gain if the total value of the consideration does not exceed ₦1,000 in a year of assessment (Section 37(1). If the proceeds of disposal exceed ₦1,000 in an assessment year, the amount of CGT chargeable on the gain shall not exceed half the difference between the amount of that proceed and ₦1,000.

(iv) A motor vehicle for carriage of passengers is an exempt asset for CGT purposes unless it is of a type not commonly used as private vehicle and is unsuitable to be so used (Section 38).

(v) Section 39 exempts assets acquired by way of gift and disposed of in a similar manner.

(vi) Section 40 - exempts capital gains accruing to a diplomatic body

(vii) Double taxation relief is applicable to CGT as it is applicable to income tax under PITA and company's income tax under CITA with the substitution of the words capital gains for income and profits and CGT for income tax.

(viii) The following exemptions have been included with effect from 1993:
- Gains arising from takeover, absorption or merger provided that no cash payment is made in respect of the shares disposed/ acquired (Section 32A).
- Gains arising in respect of disposals of securities in a Unit Trust provided the proceeds are re-invested (Section 32B)

Stocks and shares of every description are exempted with effect from 1 January, 1998.

5.8 DISPOSAL AND ACQUISITION OF ASSETS

Meaning of 'Disposal'

Except as specifically exempted by the Act, there is a disposal of assets by a person where any capital sum is derived from a sale, lease, transfer, assignment, compulsory acquisition or any other disposition of assets, notwithstanding that no asset is acquired by the person paying the capital sum, and in particular:

(a) Where any capital sum is derived by way of compensation for any loss of office or employment;
(b) Where any capital sum is received under a policy of insurance and the risk of any kind of damage or inquiry to, or the loss, or depreciation of, assets;
(c) Where any capital sum is received in return for forfeiture or surrenders of rights or from refraining from exercising rights;
(d) Where any capital sum is received as consideration for use or exploitation of any asset; and
(e) Without prejudice to paragraph (a) above where any capital sum is received in connection with or arises by virtue of any trade, business, profession or vocation (Section 6(1).

It is also stated in the Act that disposal includes reference to part disposal.

When An Acquisition/Disposal Is Effective

Acquisition/disposal takes effect on the date of the contract to acquire/dispose of the asset or on a date at which there is an enforceable right to acquire or a binding duty to dispose of the asset or any right or interest therein, and in particular:

(a) Where any contract is to be performed subject to any condition, the date of acquisition/disposal shall be the date when the condition is satisfied, but where a consideration of such contract does not depend solely or mainly on the value of the asset at the time the condition is satisfied, the acquisition/disposal shall be treated as if the contract had never been conditional, in which case the effective date shall be the date of the contract.
(b) Where an option is conferred by virtue of any contract, the date of the acquisition or disposal of asset shall be the date when the option is exercised (Section 11).

Hire Purchase Transactions

Where a fixed asset is purchased under hire-purchase, the cost for tax purposes is the cash price of the asset. The hire-purchase charges which represent the interest charges are allowable deductions under Section 20 of CITA in arriving at the assessable profits.

Thus, for Capital Gains Tax purposes, if all the instalments have been paid before the date of disposal, it is the full cash price that is taken as the cost for Capital Gains Tax purposes. If the instalments have not been fully paid, the cost of the asset at the time of disposal will be the cash price portion of the instalments paid to the date of disposal.

ILLUSTRATION 5.1

Union Company Ltd. purchased a chargeable asset on hire-purchase. The deposit paid for the purchase was N250,000. The balance of the purchase price was to be paid in thirty-six monthly instalments of N25,000. The cash price of the asset is N790,000.

Required:

Calculate the Capital Gains Tax due assuming the assets were sold as follows:

(a) For ₦1.25million after payment of twenty-four instalments.

(b) For ₦1.3 million after full payment of all the instalments.

SUGGESTED SOLUTION 5.1

		N'000	N'000	N'000
(a)	Disposal after 24 instalments paid			
	Sales price			1,250
	Less: Cost of the asset:			
	Deposit		250	
	Instalments paid totaled (24 x N25,000)	600		
	Less: interest element (24 x N10,000)	240		
			360	
				(610)
	Capital Gains			640
	Capital Gains Tax at 10% thereof			64
(b)	Disposal after full payment of all instalments			
	Sales Price			1,300
	Less: Cost:			
	Deposit		250	
	Instalments paid (36 x N25,000)	900		
	Less interest element (36 x N10,000)	360		
			540	
				790
	Capital Gains			510
	Capital Gains Tax at 10% thereof			51

Calculation of interest element of each instalment

Deposit	250
Total payable by instalments (36 x 25)	900
Total hire-purchase price	1,150
Less: the cash price	790

Total interest element	360
Total number of instalments (360 ÷ 36)	
Interest element of each instalment	10

For simplicity, the interest element has been apportioned on the 'straight-line' basis.

Bargains comprising two or more transactions

Section 20 CGTA provides:
Where a single bargain comprises two or more transactions whereby assets are disposed of, those transactions shall be treated for the purposes of computing capital gains as a single disposal.

Where separate considerations are agreed or purported to be agreed for any two or more transactions comprised in one bargain (whether transactions whereby assets are disposed of or not) those considerations shall be treated as altogether constituting an entire consideration for the transactions and shall be apportionable between them accordingly.

Where any apportionment under this Section shall result in lesser consideration than that agreed (or purported to be agreed) in the bargain being attributable to the disposal of the assets, the separate considerations agreed (or purported to be agreed) in respect of those assets shall be deemed to be the consideration for which those assets are disposed of.

Part Disposal
Where there is a part disposal, the cost of that part of asset disposed and that of the undisposed part shall be apportioned. The cost to be apportioned to the part disposed shall be in the proportion that the consideration for the disposal bears to the total value of the whole asset on the date of disposal. The value of the whole asset on that date is the consideration received in respect of the part disposed plus the market value of the part of the asset which remains undisposed (Section 17).

Thus if 'A' is the consideration received in respect of that part disposed of, and 'B' is the market value of the part which remains undisposed, then the apportionment will be based on the formula

$$\frac{A}{A + B}$$

which shall be applied in computing the cost and/or all other sums allowable as a deduction in computing the amount of the gain accruing on the disposal, the remainder being attributable to the property which remains undisposed of.

Connected persons

In tax practice, certain persons are treated as being so closely involved with each other that they have to be viewed as the same person or that transactions between them need to be treated differently from those 'at arm's length'. These persons are referred to as 'connected persons'. Transactions between such persons may be regarded as artificial or fictitious for the purpose of determining the tax liability arising therefrom. This implies that the Revenue can make whatever adjustments as it considers necessary to counteract the reduction of liability to tax that could otherwise result from such transactions.

Transactions between connected persons

Where a person acquires an asset and the person making the disposal is connected with him, the person acquiring the asset and the person making the disposal shall be treated as parties to a transaction made otherwise than by way of a bargain at arm's length (Section 23(1 & 2).

The consideration shall be disregarded if less than the market value, and the consideration shall be deemed to be the market value.

Connected persons (Section 24)

(a) An individual is connected with his/her spouse and with his/her relatives and their spouses;

(b) A trustee of a settlement is connected with the settlor of that settlement, and with any person connected with the settlor;

(c) A partner is connected with the person with whom he is in partnership and with the spouse or relative of that person;

(d) A company is connected with another company if –
   - (i) The same person controls both, or
   - (ii) One is controlled by a person who has control of the other in conjunction with persons connected with him, or
   - (iii) A person controls one company and persons connected with him control the other or
   - (iv) The same group of persons controls both, or
   - (v) The companies are controlled by separate group which can be regarded as the same by interchanging connected persons.

(e) A company is connected with another person who (either alone or with persons connected with him) has control of it; and

(f) Persons acting to secure or exercise control of a company are treated in relation to that company as connected with each other and with any other person acting on the direction of any of them to secure or exercise such control.

'Relative' is also defined in the Act as meaning, brother, sister, ancestral or lineal descendant.

Consideration

Consideration for asset acquired/disposed of shall be deemed to be equal to the market value of the asset where any person acquires the asset:

(a) Otherwise than by way of a bargain made at arm's length;

(b) Wholly or partly for a consideration that cannot be valued or in connection with his own or another's loss of office or employment or diminution of emolument, or otherwise in consideration for or recognition of services or past services;

(c) As trustee for creditors of the person making the disposal (Section 7(1)).

Where a person donates an asset acquired by him by way of a gift (not being an acquisition on a devolution on death) or otherwise, the person receiving the donation shall, for all purposes of the Act, so far as it relates to the interest taken by him, be deemed to have acquired the asset:

(i) In a case where the amount of the consideration for which the asset was last disposed of by way of a bargain made at arm's length is ascertainable, for a consideration equal to that amount; and

(ii) In any other case, for a consideration equal to the market value of the asset on the date of that disposal; and in this subsection "gift" does not include a donation mortis causa (Section 7(2)).

The conveyance or transfer by way of security of an asset (including a retransfer on redemption of the security), shall not be treated for the purposes of the Act as involving any acquisition or disposal of the asset (Section 7(4)).

Where a person entitled to an asset by way of security or to the benefit of a charge or encumbrance on an asset deals with the asset for the purpose of enforcing or giving effect to the security, charge or encumbrance his dealings with it shall be treated for the purposes of the Act as if they were done through him as nominee of the person entitled to it subject to the security, charge or encumbrance; and this subsection shall apply to the dealings of any person appointed to enforce or give effect to the security, charge or encumbrance as receiver and manager or judicial factor as it applies to the dealings of the person entitled as aforesaid (Section 7(5).

An asset shall be treated as having been acquired free of any interest or right by way of security subsisting at the time of any acquisition of it, and as being disposed of free of any such interest or right subsisting at the time of the disposal; and where an asset is acquired subject to any such interest or right the full amount of the liability thereby assumed by the person acquiring the asset shall form part of the consideration for the acquisition and disposal in addition to any other consideration (Section 7(6)).

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's acquisition of it, and if a chargeable gain accrues to the creditor on a disposal by him of the asset the amount of the chargeable gain (where necessary) shall be reduced such that it will not exceed the chargeable gain which would have accrued if he had acquired the property for a consideration equal to the amount of the debt or that part thereof (Section 7(7)).

Any amount that can be treated as income or profits for the purposes of the Income Taxes Acts shall be excluded from the consideration for a disposal of assets for capital gains tax computation (Section 13)).

Consideration payable by instalments

When the consideration is payable by instalments 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 up to the assessment year in which the last instalment is payable in the proportion of the amount of the instalments payable in each of the years. Such chargeable gain shall be deemed to accrue on the last day of each of the year of assessments in which the instalments are received (Section 18)).

No allowance is given for possible bad debts at the time of computing the capital gains tax payable. However, if any part of the consideration already brought into the computation is subsequently shown to the satisfaction of the Revenue Service as irrecoverable, such adjustment, whether by way of discharge, or repayment of tax or otherwise, shall be made as is required in consequence (Section 18(5)).

Death (Section 8)

On the death of an individual, any asset 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 the asset was last disposed of by way of a bargain made at arm's length if ascertainable, or

(b) In any other case, the market value of the asset at that date; (subsection 1).

The gains which accrue in consequence of subsection (1) of this Section shall not be chargeable to capital gains 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).

On a person acquiring any asset as legatee:

(i) No chargeable gain shall accrue to the personal representatives; and

(ii) The legatee shall be treated as if the personal representatives' acquisition of the asset had been his acquisition of it, (subsection 4).

In this Section:
"Legatee" includes 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 not as a gift;

"Personal representatives" means
(a) The executor, original or by representation, or administrator 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 paragraph (a) of this subsection, and references to personal representatives as such shall be construed as references to the personal representatives in their capacity as having such functions as aforesaid, (subsection 7).

Assets Lost or Destroyed (Section 19)
If a capital sum is received by way of compensation for the loss or destruction of an asset whether under a policy of insurance or not, a relief is available to the owner, if the amount is applied within three years of receipt in acquiring a replacement of the asset lost or destroyed.

The owner can claim:
(a) As if the consideration for the disposal of the old asset were (if otherwise of a greater amount) of such amount as would secure that neither a loss nor a gain accrued to him on the disposal; and
(b) As if the consideration for the acquisition of the new asset were reduced by the excess of the amount of the capital sum received together with any residual value or scrap value, over the amount of the consideration which he is treated as receiving under paragraph (a) above.

If part of what would have been the chargeable gain (but for this provision) is what is reinvested, then the relief available will be proportionally reduced.

5.9 RELIEFS

5.9.1 Delayed Remittances 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:
(a) He was unable to transfer those gains to Nigeria; and
(b) That inability was due to the laws of the country where the income arose, or to the executive action of its government, or to the impossibility of obtaining foreign currency in that territory; and

(c) The inability was not due to any want of reasonable endeavours on his part.

Section 42(2) - If he so claims, then for the purposes of capital gains tax:

(i) There shall be deducted from the amounts on which he is assessed to Capital Gains Tax for the year in which the chargeable gain accrued to the claimant the amount as respects which the conditions in paragraphs (a), (b) and (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 in respect of any chargeable gain more than six years after the end of the year of assessment in which that gain accrues.

Section 42(4) - The personal representatives of a deceased person may make any claim which he might have made under this Section if he had not died.

5.9.2 Roll-Over Relief (Section 32 CGT Act)

If the consideration received on disposal of an old asset 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 trade and the old asset and the new asset are within one, 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 CGT purposes as if the:

(a) Consideration for the disposal of the old asset 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) Value of the consideration for the acquisition of the new asset were reduced by the excess of the value of the actual consideration for the disposal of the old asset over the amount of the consideration which he is treated as receiving under paragraph (a) above.

The foregoing will not have any effect on the parties to the transactions involving the old or new assets other than the claimant. This is to say that the purchaser of the old asset will still be treated as acquiring that asset at the price which he has paid for it while the seller of the new asset will be treated as having sold the new asset at the price he received for it.

ILLUSTRATION 5.2

Mr. Niger sold his factory buildings which he acquired ten years ago for N500,000. The cost of acquisition at that time was N100,000. He acquired a new factory for N750,000 to enable him carry on his business.

SUGGESTED SOLUTION 5.2

For CGT purposes, and upon Mr. Niger 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 N100,000 and therefore no Capital Gains Tax is payable; and

(b) as if the cost of acquisition of the new asset (N750,000) were reduced by the excess of the actual proceeds of disposal of the old asset (N500,000) over the amount of the proceeds which he is treated as receiving under para (a) (N100,000), that is, N400,000 which would otherwise be the capital gain on the disposal of the old asset, will be deducted from the cost of the new asset.

Thus, the cost of the new asset for Capital Allowances and CGT purposes will be N350,000 (N750,000 – N400,000). This is what is referred to as roll-over relief in CGT practice. The liability to CGT on gains which have been fully reinvested in the same asset used for the same trade being deferred until the replacement asset is finally disposed.

Note that where the insurance compensation money for the 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).

Continuing with the example of Mr. Niger from above, the purchaser of Mr. Niger's factory will not be affected by this arrangement neither will the seller of the new factory as they will record their transactions as having purchased and sold the factories for N500,000 and N750,000 respectively.

If only part of the proceeds of disposal is reinvested and the amount reinvested is greater than the cost of the old asset, the owner, if he so claims, shall be treated:

(a) as if the amount of the gains so accruing were reduced to the amount of the said part with a proportionate reduction in the amount of the chargeable gain, and

(b) as if the amount of the consideration for the acquisition of the new asset were reduced by the amount by which the gain is reduced under para(a) above.

In other words, if the proceeds are not fully reinvested, the amount of relief available will be the proportion which the gain reinvested bears to the total gain accruing on the disposal.

For the foregoing to be applicable, the acquisition of the new asset should be completed within the period of twelve months before and twelve months after the date of the disposal of the old asset or at such earlier time as the Revenue Service may by notice in writing allow.

Where an unconditional contract for the acquisition has been entered into, this Section may be applied on a provisional basis without waiting to ascertain whether the new asset is acquired in pursuance of that contract. When the fact is ascertained, all necessary adjustments shall be made by making additional assessments or by repayment or discharge of tax, and shall be made notwithstanding any limitation in the Act on the time within which assessments may be made. The assets to which this Section applies are classified as follows:

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 asset. 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 on 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 asset used for the purposes of the one trade and new assets used for the purposes of the other trade, the two trades were the same (Section 32.9)

This Section shall apply with the 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 provisions of those Acts as to the circumstances in which, on a change in the persons carrying on a trade, a trade is to be regarded as discontinued, or as set up and commenced (Section 32.10).

5.10 OFFENCES AND PENALTIES

There is no special provisions in Capital Gains Tax Act relating to offences and penalties. The CGT Act however provide that Part XIII of the Companies Income Tax Act (CITA) CAP C21 LFN 2004, on offences is applicable to CGT.
Please see details of offences and penalties as stated in Chapter 7 of this manual.

5.11 OTHER MATTERS

(a) Artificial or Fictitious Transactions

Where the Revenue Service 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 Revenue Service 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 gains tax as it considers appropriate so as to counteract the reduction of liability to capital gains tax effected or reduction which would otherwise be effected, by the transaction and any person concerned with such transaction shall be assessable accordingly (Section 21(1)).

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)).
"Disposition" includes any trust, grant, covenant, agreement or arrangement: (Section 21(3)(a)).

Transactions between connected persons shall be deemed to be artificial or fictitious, if in the opinion of the Revenue Service 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(3)(b)).

In relation to any direction made under this Section, the provision of the Act as to appeals against an assessment shall have effects as if such direction were an assessment (Section 21(3)(c)).

(b) Location of Assets

For the purposes of the Act:

(i) The situation of rights or interests (otherwise than by way of security) in or over immovable property is that of the immovable property;

(ii) Subject to the following provisions of this subsection, the situation of rights or interests (otherwise than by way of security) in or over tangible movable property is that of the tangible movable property;

(iii) Subject to the following provisions of this Section, a debt, secured or unsecured, is situated in Nigeria if and only if the creditor is resident in Nigeria;

(iv) Shares or securities issued by any governmental, municipal, local or native authority, or by any body created by such an authority are situated in the country of that authority or place where the authority is situated;

(v) Subject to paragraph (d) of this Section, registered shares or securities are situated where they are registered and, if registered in more than one register, where the principal register is situated;

(vi) A ship or aircraft is situated in Nigeria if and only if the owner is then resident in Nigeria, and an interest or right in or over a ship or aircraft is situated in Nigeria if and only if the person entitled to the interest or right is resident in Nigeria;

(vii) The situation of goodwill of a trade, business or professional asset is at the place where the trade, business or profession is carried on;

(viii) Patents, trade-marks and designs are situated where they are registered, and if registered in more than one register, where each register is situated, and copyright, franchises, rights and licences to use any copyright material, patent, trade-mark or design are situated in Nigeria if they, or any rights derived from them, are exercisable in Nigeria; and

(ix) A judgement debt is situated where the judgement is recorded (Section 25).

(c) **Assets Located Outside Nigeria (Section 4)**

Capital Gains Tax is payable on the gains arising on the disposal of assets situated outside Nigeria, so long as the proceeds are received in, or brought into Nigeria.

The Tax is due:

(i) Where the disposal is by an individual who:

- Is visiting Nigeria temporarily with no intent to establish residence, and

- Spends more than 183 days out of a 12 month period, in Nigeria.

(ii) Where the disposal is by a Non-Nigerian Company, managed and controlled from outside Nigeria.

(d) **Other Provisions**

(i) Section 22(1) – Market value in relation to any assets means the prices which those assets might reasonably be expected to fetch on a sale in the open market.

(ii) Section 22(2) – In estimating the market value, no reduction shall be made in the estimate on the account that the estimate is based on the assumption that the whole of the assets is to be placed on the market at one and the same time.

(iii) Section 22(3) – In re-estimating the market value of any assets acquired, if the market value exceeds the consideration actually paid by the acquirer, the assets shall be deemed to have been acquired for the amount actually paid by the acquirer.

(e) **Anti-Avoidance Provision – Section 44(3)**

Without prejudice to the provisions of the Stamp Duties Act, the Minister with responsibility for matters relating to Stamp Duties shall demand tax clearance certificates when checking documents on sale by any company of landed property and other assets before accepting such documents for stamping.

Another anti-avoidance provision has been introduced with effect from 1 January 1993. It makes the production of evidence of tax payment a condition for effecting change of ownership of property, including shares and stocks (Section 44A).

5.12 CHAPTER REVIEW

This chapter deals with the taxation of gains that cannot be regarded as income. Such gains are classified as capital gains, as they cannot be included in income for income tax purposes.

This chapter shows that Capital Gains Tax will be due on chargeable capital gains arising on disposal of capital assets to the extent that such are not specifically exempted by the Act. The current rate of the Capital Gains Tax is 10%.

Capital loss on disposal of an asset cannot be relieved against the capital gains on another asset even if the two assets are in the same class.

5.13 WORKED EXAMPLES

5.13.1 Questions

(1) Best Manufacturing (Nig.) Limited is engaged in the production of building materials in Ota, Ogun State. Due to sudden power surge at night, one of the two factories got burnt before fire fighters arrived the scene.

The factories were comprehensively insured with MACON Insurance Company Plc. The management decided to move the factory from Ota to Lagos State. Concerted efforts were made to acquire land for a new factory in Ejigbo and the factory in Ota that was not burnt which cost N1,800,000 six years earlier, was sold for N4,200,000 in March 2007. The amount formed part of the cost of construction of the new factory at Ejigbo which was completed in November 2007, at a cost of N5,600,000.

In 2008, for the Ota factory costing N3,700,000, the insurance company paid N5,900,000 to Best Manufacturing (Nig.) Ltd. Out of the compensation received, N4,600,000 was spent on the construction of the new factory in Ejigbo whilst the balance was put in a fixed deposit account to yield interest.

Best Manufacturing (Nig.) Ltd has just appointed you as the company's Tax Consultants.

Required:
Advise the management on:

(a) The Capital Gains (if any) arising from the events
(b) The Capital Gains tax payable
(c) How the company can reduce the Capital Gains Tax payable.

(2) Janid Investment Limited sold its two buildings situated on Lagos- Badagry Expressway, Amuwo, Lagos and another in Ibadan. The building in Lagos was compulsorily acquired by the State Government in June 2008 in the course of the dualisation of the road. A compensation of N25,000,000 was paid for the building which originally cost the company N2,500,000. Fearing that the same predicament might befall the Ibadan building, the company quickly sold the building for N15,500,000 on 6 July 2008. Its original cost was N850,000. Sales expenses amounted to N3,250,000.

The company normally makes accounts to 31 December, each year and the properties which were sold and purchased were

reflected in the accounts to 31 December 2008. The company decided to move to Ogun State where between September and November 2008, it acquired a new site and erected another business building at a cost of N20,500,000.

Required:

(a) Compute the Capital Gains Tax liability for the relevant year of assessment.

(b) State one other alternative open to Janid Investments Limited in discharging its Capital Gains Tax liability and the time limit for exercising the option.

(3) In April 2004, Dr. Mensah acquired a house at a cost of N60 million. Other acquisition expenses incurred were N100,000 for legal fees and N200,000 valuation fee. On 30 November 2004, a duplex was constructed in the excess space at a cost of N12 million.

On June 1 2005, the duplex was sold to Uncle Jimmy for N16 million. The actual market value was N20 million and the value of remaining property was N68 million. On 1 January 2006, Dr. Mensah sold the remaining property for N72 million after paying for the following expenses:

		N
(a)	Improvements prior to sale	1,000,000
(b)	Estate Agency fees	400,000
(c)	Legal fees	120,000
(d)	Advertising	240,000
		1,760,000

Required;

Compute the Capital Gains tax for the relevant years of assessment.

(4) (a) Mention any **FIVE** categories of Instruments that are subject of Stamp Duties under the Stamp Duties Act CAP S8 LFN 2004.

(b) MELTDOWN CONSTRUCTION LIMITED purchased a bulldozer on hire purchase on 1 February 2007 and paid a sum of N28,500,000 as a deposit on the purchase price. The cash price of the bulldozer at the time of purchase was N45,000,000, but Meltdown Construction Limited was allowed to pay the balance in twenty monthly instalments of N1,000,000 each with effect from 1 March 2007.

Required:
Calculate the Capital Gains Tax for the relevant year of assessment, assuming that the bulldozer was sold for:

(i) N48,400,000 after the payment of instalments on 3 December 2007.
(ii) N49,600,000 after the payment of instalment on 5 September 2008.

(5) White Cleaners Ltd. is involved in dry cleaning business. The company acquired a building for the business within Shonibare Estate, Maryland, in the year 2001 at a cost of N25,000,000. It also acquired dry cleaning equipment and a generating set at the costs of N5,000,000 and N3,500,000 respectively.

The wrong location of the company coupled with the poor performance of equipment some of which were refurbished but wrongly believed to be new resulted in low patronage. The company resolved to make a new start in the year 2003 by selling off everything to use the proceeds to augment the acquisition of new ones.

The building was sold for N30,000,000 while the equipment and generating set were sold for N3,500,000 and N4,300,000, respectively.

A new building was acquired on Victoria Island for the same business at N65,000,000 while the equipment and new generating sets were acquired for N7,500,000 and N3,000,000 respectively.

You are required to compute:
(a) The Capital Gains
(b) The roll-over relief available (if any)
(c) Capital Gains Tax payable
(d) The costs on which capital allowances will be granted to the company based on the newly acquired assets.

(6) Erron Nigeria Limited is a company engaged in the manufacturing of nails. Due to fall in demand for its products, it decided to move its factory from Abeokuta to Lagos State.
Concerted efforts were made to acquire land for the new factory in Ojodu Village. The warehouse in Abeokuta which cost N900,000 six years earlier was sold for N2,100,000 in March 1998,.The amount formed part of the cost of construction of the new factory at Ojodu Village which was completed in November 1998 at a cost of N2,800,000.

In 1999, the Abeokuta factory costing N1,850,000 was sold for N2,950,000. Out of the sales proceeds N2,300,000 was spent on the construction of the second factory in Ojodu Village whilst the balance of N650,000 was put in a fixed deposit account to generate interest.

Required:

(a) Compute the Capital Gains made on the project

(b) Compute the Capital Gains Tax Payable

(c) Suggest how the company can reduce the Capital Gains Tax payable.

5.13.2 Suggested Solutions

1. **XYZ & CO. (CHARTERED ACCOUNTANTS)**
 2, AYODEJI STREET, IKEJA – LAGOS STATE

O/R Y/R 15 November 2009

The Managing Director,
Best Manufacturing (Nig.) Ltd.,
Ejigbo,
Lagos State.

Dear Sir,

RE: ADVICE ON TAX IMPLICATIONS OF DISPOSAL OF A PROPERTY/ INSURANCE CLAIMS RECEIVED ON DESTROYED PROPERTY

We are in receipt of your letter dated 5 November 2009, appointing us as your company's Tax Consultants and specifically requesting for our advice on the following under-listed areas:
Capital Gains (if any) arising from the transactions;
The Capital Gains Tax payable; and
Suggestions on ways of reducing the Capital Gains Tax.

After thorough examination of the information provided in your letter under reference, we state as follows:

(a) In respect of item (a) Appendix I shows the Capital Gains for Assessment Years 2007 and 2008.

(b) For the Assessment Year 2007, your company is not liable to Capital Gains Tax for the fact stated under Appendix I, while for Assessment Year 2008, the Capital Gains Tax is N130,000, as shown under Appendix II.

(c) In our opinion, for your company to have a reduced liability on capital gains tax, the full proceeds of N5,900,000 should be applied to Ejigbo factories, thus having a full benefit of roll over relief in 2008 Assessment Year.

We have based all our computations on the following provisions of the tax laws.

(i) Assets lost or destroyed and replacement of business assets

(ii) Roll over relief on re-investment of disposal proceeds of similar assets

(iii) The mandatory period of 12 months of disposal of old Assets within which re-investment occurred.

As shown in our computations, your company was liable to Capital Gains Tax in 2008, because the amount reinvested was less than the claim proceeds.

Should you require any further clarifications or explanation, we would be most obliged to do so.

Once again, we use this opportunity to thank you for your understanding and cooperation and for considering us for this assignment.

Yours faithfully,
For: XYZ & Co. (Chartered Accountants)

PETER JAMES
MANAGING PARTNER

(a) **APPENDIX I**

BEST MANUFACTURING NIG. LTD

Capital Gains for 2007 year of assessment	₦000
Disposal of OTA warehouse	
Sales proceeds	4,200
Less: Cost of acquisition	(1,800)
Capital Gains	2,400
Amount reinvested in Ejigbo	5,600
Capita Gains rolled over	2,400

Reason: the amount reinvested is greater than the sale proceeds.

(b) **CAPITAL GAINS FOR 2008 YEAR OF ASSESSMENT**

Disposal of OTA Factory	**N000**
Claim from MACON	5,900
Less: Cost of acquisition	(3,700)
Capital Gains	2,200

	₦
Claim from MACON	5,900
Amount reinvested	(4,600)
Chargeable Gains	1,300
Amount rolled over (partial)	
Total Capital Gains	2,200
Less: Chargeable gain	(1,300)
Amount Rolled over	900
Total Capital Gains made on the project	
2007 Year of assessment – Disposal of warehouse	2,400
2008 Year of assessment – Disposal of factory	2,200

APPENDIX II

CAPITAL GAINS TAX PAYABLE	₦000
2007 Year of assessment	Nil
2008 Year of assessment (N1,300,000 x 10%)	130

c. **WAYS TO REDUCE THE CAPITAL GAINS TAX**

In order to reduce the Capital Gains Tax, the full proceeds of N5,900,000 should be applied to Ejigbo factories so that the company can benefit from full roll-over relief in 2008 assessment year.

2. **JANID INVESTMENTS LIMITED**

(a) Computation of Capital Gains Tax Liability for 2008 Year of Assessment

	Lagos Building	Ibadan Building
	₦	₦
Compensation/sales proceeds	25,000,000	15,500,000
Deduct:- Sales expenses	-	(3,250,000)
Net Compensation/Sales	25,000,000	12,250,000
Deduct:- Acquisition costs	(2,500,000)	(850,000)
Capital Gains	22,500,000	11,400,000
Capital Gains Tax (10%)	NIL	1,140,000

The Capital Gains arising on the Lagos building is exempted from Capital Gains Tax, because it relates to a compulsory acquisition of property by an authority that has the power to do so.

(b) The company can discharge its Capital Gains Tax liability by claiming Roll-Over-Relief from the disposal of the Ibadan building. Full Roll Over Relief will be granted if the whole of the consideration of N15,500,000 obtained from the sale of the Ibadan building is reinvested in the construction of the Ogun building.

The time limit within which the proceeds from the sale of the old asset must be reinvested in the new asset is a period beginning twelve months before and ending twelve months after the disposal of the old asset. "Please note that the tax law did not specify the time limit for claiming Roll-Over Relief."

3. **DR MENSAH**
COMPUTATION OF CAPITAL GAINS TAX FOR 2005 AND 2006 TAX YEARS

2005 – 01/01/05 to 31/12/2005

	₦	₦
Consideration received:		
(Market value of duplex)		20,000,000
Deduct: Cost of duplex		(12,000,000)
Capital Gains		8,000,000
Capital Gains Tax @ 10%		800,000
2006-01/01/06 to 31/12/2006		
Consideration received		72,000,000
Deduct: Incidental Selling Expenses:		
Estate Agency Fees	400,000	
Legal Fees	120,000	
Advertising	240,000	(760,000)
Net Proceeds		71,240,000
Deduct: Cost of acquisition		
Consideration paid	60,000,000	
Incidental cost of acquisition:		
Legal fees	100,000	
Valuation fee	200,000	
Cost of improvements	1,000,000	
		(61,300,000)
Capital Gains		9,940,000
Capital Gains Tax @ 10%		994,000

4. (a) Categories of Instruments subject to Stamp Duties under the Stamp Duties Act CAP S8 LFN 2004 include:
   (i) Agreements;

(ii) Appraisement;
(iii) Bank Notes, Bills of Exchange and Promissory Notes;
(iv) Bills of Exchange
(v) Bills of Lading;
(vi) Contract Notes;
(vii) Conveyances on sale and other conveyances;
(viii) Duplicates and Counterparts;
(ix) Exchange, Partition or Division;
(x) Leases;
(xi) Letters or Power of Attorney and Voting Powers;
(xii) Marketable Securities;
(xiii) Mortgages;
(xiv) Notarial Acts;
(xv) Policies of Insurance;
(xvi) Receipts;
(xvii) Settlements;
(xviii) Share Warrants;
(ix) Warrants for Good; and
(x) Share Capital of Companies.
(xii) Documents requiring postage stamp: and
(xiii) Transactions in the Capital Market.

(b) (i) **MELTDOWN CONSTRUCTION LIMITED COMPUTATIONS OF CAPITAL GAINS TAX FOR 2007 YEAR OF ASSESSMENT**

	₦	₦	₦
Sales proceeds of bulldozer			48,400,000
Cost of bulldozer			
Deposit paid		28,500,000	
Instalments paid (10 months @ N1,000,000 each)	10,000,000		
Interest portion paid (W2)	(1,750,000)	8,250,000	(36,750,000)
Chargeable Gains			11,650,000
Capital Gains Tax thereon @ 10%			1,165,000

(ii) MELTDOWN CONSTRUCTION LIMITED COMPUTATIONS OF CAPITAL GAINS TAX FOR 2008 YEAR OF ASSESSMENT

	₦	₦	₦
Sales proceeds of bulldozer			49,600,000
Cost of bulldozer			
Deposit paid		28,500,000	
Instalments paid (10 months @ N1,000,000 each)	19,000,000		
Less Interest portion paid (W3)	(3,325,000)		
		15,675,000	(44,175,000)
Chargeable Gains			5,425,000
Capital Gains Tax thereon @ 10%			542,500

WORKING NOTES

(W1) Calculation of Hire Purchase Interest

Hire purchase price;

♦ Deposit (1/2/2007)	28,500,000
♦ 20 Installments Payable (March 2007 to October 2008) @ N1,000,000 per month	20,000,000
	48,500,000
Cash Price	45,000,000
Hire Purchase Interest for 20 months	3,500,000

(W2) Calculation of Hire Purchase Interest up to 1/12/2007

Hire Purchase Interest payable N3,500,000

Hire Purchase Interest at the time of Disposal – 3/12/2007

$\frac{N3,500,000}{20} \times 10$ N1,750,000

(W3) Calculation of Hire Purchase Interest up to 1/10/2008

Hire Purchase Interest for 19 months at the time of Disposal (i.e. 5/9/2008) = N175,000 x 19 months N3,325,000

5. COMPUTATION OF CAPITAL GAINS – White Cleaners Ltd.

	₦
BUILDING	
Proceeds from disposal	30,000,000
Cost of acquisition	(25,000,000)
Capital Gains	5,000,000

EQUIPMENT	
Proceeds from disposal	3,500,000
Cost of acquisition	(5,000,000)
Capital loss	(1,500,000)
GENERATING SET	
Proceeds from disposal	4,300,000
Cost of Acquisition	(3,500,000)
Capital Gains	800,000
TOTAL CAPITAL GAINS	5,800,000

Note:

Capital loss on disposal of any asset is not deductible from Capital Gains on disposal of any other asset, even if both are of the same type.

(b) **COMPUTATION OF 'ROLL OVER RELIEF'**

		N
(i)	Building	
	Proceeds from disposal	30,000,000
	Cost of acquisition	(25,000,000)
	Capital Gains	5,000,000
	Rollover relief:	
	Amount reinvested in the new building	30,000,000
	Rollover relief (See Note i)	**(5,000,000)**
	Balance liable to tax	NIL
	Capital Gains Tax payable @ 10%	NIL
(ii)	Equipment	
	Proceeds from disposal	3,500,000
	Cost of Equipment	(5,000,000)
	Capital loss	(1,500,000)
	Rollover relief	NIL
	Capital Gains Tax @ 10%	NIL

NOTES: ROLL OVER RELIEFS

Rollover relief is applicable where the capital gains have been fully/ partially reinvested in replacement of assets for the purpose of the company's business.

(i) New building was acquired at N65,000,000, hence the N30million proceeds from the disposal of the old asset and the Capital Gains had been fully reinvested in the replacement assets – rollover relief is available.

(ii) On the equipment there was no rollover relief because of capital loss incurred.

(iii) On the generating set, there was no rollover relief because the new asset was purchased at a lower cost than the one replaced, therefore no part of the capital gain was reinvested.

(c) **CAPITAL GAINS TAX PAYABLE**

This is applicable only on Generating Set

	N	N
Proceeds from disposal	4,300,000	
Cost of old Generating Set	(3,500,000)	
		800,000
Rollover relief		
Amount reinvested in the new set	3,000,000	
Cost of old Generating set	3,500,000	
	NIL	NIL
Balance liable to CGT		800,000
Capital Gains Tax @ 10%		80,000

(d) The costs at which allowances are based for the newly acquired assets are:

		N
(i)	Building	
	Cost of new building	65,000,000
	Rollover relief	(5,000,000)
	Cost for Capital allowance purposes	60,000,000
(ii)	Generator	
	Cost of new generating set	3,000,000
	Rollover relief	-
	Cost for Capital allowance purposes	3,000,000
(iii)	Equipment	
	Cost of new equipment	7,500,000
	Rollover relief	-
	Cost for Capital allowance purposes	7,500,000

Notes on claiming roll-over reliefs

(i) The asset disposed of must have generated Capital Gain

(ii) The new asset must cost more than the sales proceeds of the disposed asset and

(iii) The amount reinvested in the new asset must exceed the cost of the old asset, in other words, you can't have a loss on disposal of an old relevant asset and hope to claim Roll-over Relief on the class of asset.

(iv) Cost for capital allowance purposes is acquisition cost less Roll-over Relief (if any).

6. **ERRON NIGERIA LIMITED**
CAPITAL GAINS TAX COMPUTATION 1999

	₦	₦	₦
Disposal of Abeokuta Warehouse:			
Proceeds			2,100,000
Cost of Warehouse			900,000
Chargeable Gain			1,200,000
Disposal of Abeokuta Factory:			
Proceeds		2,950,000	
Cost		1,850,000	
Chargeable Gain		1,100,000	
In view of the reinvestment of ₦2,300,000 in the new factory, the company is entitled to a roll-over relief Proportion of the gain reinvested			
Cost of Ojodu factory	2,300,000		
Cost of Abeokuta factory	(1,850,000)	(450,000)	
Proportion of the gain to be relieved			650,000
Total Chargeable Gains			1,850,000
Capital Gains Tax Payable 10% of N1,850,000			185,000

(c) In order to reduce the capital gains tax, the proceeds of disposal of the Abeokuta warehouse should be applied in the construction of the Ojodu warehouse and the full proceeds of N2,950,000 should be applied to Ojodu factory so that the company can benefit from a rollover relief.

CHAPTER 6

Ascertainment of Tax Liabilities

Contents

1. Purpose
2. Introduction
3. Imposition
4. Trade or Business
5. Dividends
6. Authorised Unit Trust Scheme
7. Exemptions
8. Determination of Profits
9. Allowable Deductions
10. Disallowable Expenditure
11. Waiver or Refund of Liability or Expense
12. Basis of Assessment
13. Company in Partnership with Another
14. Total Profits and Sources of Profits
15. Losses
16. Normal Company Tax Rates
17. Tertiary Education Tax
18. Small Business Rate
19. Pre-Operation Levy
20. Information Technology Tax
21. Withholding Tax
22. Capital Allowances
23. Deferred Taxation
24. Chapter Review
25. Worked Examples

6

ASCERTAINMENT OF TAX LIABILITIES

6.0 PURPOSE

After studying this chapter, readers should be able to:

(a) know the various profits or incomes that are taxable or exempted from Companies income tax under Companies Income Tax Act CAP C21 LFN 2004 (CITA);

(b) understand the principles of allowable and disallowable deductions as applicable to Companies chargeable to tax under CITA;

(c) know how basis period of assessment is to be determined;

(d) know how to aggregate income from all sources to arrive at Total profits;

(e) know the provisions of CITA with regards to loss relief;

(f) be able to prepare applicable Assessable Profits computations applying the provisions of CITA to new trade, ongoing trade, cessation of trade and change of accounting date;

(g) understand the provisions of the Second Schedule to CITA dealing with Capital Allowances;

(h) know the classification of Qualifying Capital Expenditure and the applicable Capital Allowances;

(i) know the conditions stipulated in the Act for the granting of Capital Allowances to companies and how the allowances are granted;

(j) understand how basis period for Capital Allowances computation is determined;

(k) prepare Capital allowances computations in line with the applicable provisions of CITA;

(l) know the roles of Agents in withholding tax collection;

(m) identify various transactions that attract Withholding Tax;

(n) determine payments due to either FIRS or SIRS; and

(o) be conversant with payments schedule and the various rates in use.

6.1 INTRODUCTION

Companies Income Tax is chargeable on the income of all companies operating in the country except those specifically exempted under the Act. There is a clear distinction between Nigerian and non-Nigerian companies. A Nigerian company is defined as one incorporated under the Companies and Allied Matters Act, (CAMA) 2004, as amended. The Total profits of such companies are assessable to Nigerian tax irrespective of whether or not all the profits have been derived from, brought into or received in Nigeria.

A foreign company (non-Nigerian company) is defined as any company or corporation established by or under any law in force in any territory or country outside Nigeria, that is, a company that is not incorporated under CAMA.

The profits of a non-Nigerian company shall be subject to Nigerian tax only to the extent to which such profits are attributable to the company's operations in Nigeria, subject to provisions in the respective double taxation agreements, if any, available within the country where the foreign company is registered. Withholding tax of 10% is deductible from dividends, interests or royalties due to non-Nigerian companies arising in Nigeria.

In short, Companies income tax is chargeable on:

(a) The global profits of Nigerian companies irrespective of whether or not they are brought into or received in Nigeria. Dividend income to a Nigerian company is treated as Franked Investment income on which no income tax is due.
(b) The portion of the profits of non-Nigerian companies derived from such companies' operations in Nigeria.
(c) Dividends, interests or royalties due to non-Nigerian companies which are assessed at 10% (withholding tax rate) on the gross amount due and only the net is payable to the respective Companies.

6.2 IMPOSITION

Section 8 of Companies Income Tax Act (CITA) imposes tax at a particular rate (currently 30%) upon the profits of any company accruing in, derived from, brought into, or received in Nigeria in respect of:

(a) any trade or business;
(b) rent or any premium arising from a right granted to any other person for the use or occupation of any property. The treatment of rental income for Companies income tax purposes is the same as that for personal income tax.;
(c) dividends, interest, royalties, discounts, charges or annuities;
(d) any source of annual profits or gains not falling within the preceding categories;
(e) any amount deemed to be income or profit under a provision of the Act, or with respect to any benefit arising from a pension or provident fund, of the Personal Income Tax Act;
(f) fees, dues and allowances (wherever paid) for services rendered. Any company entering into any agreement (whether oral or written) in respect of any service in this regard is required by the Act to make full disclosure in writing to the Revenue Service of the terms of such agreement (Section 10); and
(g) any amount of profits or gains arising from acquisition and disposal of short-term money instruments like Federal Government securities, treasury bills, treasury or savings certificates, debenture certificates or treasury bonds.

Identification of a company

The incorporation number of a company and the Tax Identification Number (TIN) generated by FIRS, to which the provisions of Section 8 apply, shall serve as the identification number of the company and shall be displayed by the company on all business transactions with other companies and individuals and on every document, statement, returns, audited account and correspondence with revenue authorities, including the Department of Customs and Excise, Ministries and all Government agencies (Section 8A).

Where profits are accrued (CITA Section 11)

The profits of a Nigerian company shall be deemed to accrue in Nigeria wherever they have arisen and irrespective of their being brought into or received in Nigeria.

"The profits of a company, other than a Nigerian company from any trade or business shall be deemed to be derived from Nigeria:

(a) If that company has a fixed base of business in Nigeria, to the extent that the profit is attributable to the fixed base;

(b) If it does not have such a fixed base in Nigeria but habitually operates a trade or business through a person in Nigeria authorized to conclude contracts on its behalf or on behalf of some other 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, to the extent that the profits are attributable to the business or trade or activities carried on through that person;

(c) If that trade or business or activity, involves a single contract for surveys, deliveries, installation or construction, the profit from that contract; and

(d) Where the trade or business or activity is between the company and another person controlled by it or which has controlling interest in it and conditions are made or imposed between the company and such person in their commercial or financial relations, which, in the opinion of the Revenue Service, is deemed to be artificial or fictitious, so much of the profits adjusted by the Revenue Service to reflect arm's length transaction" (Subsection 2).

For the purposes of subsection (2)(a) of this Section, a fixed base shall not include:

(a) facilities used solely for storage or display of goods or merchandise; and

(b) facilities used solely for the collection of information.

6.3 TRADE OR BUSINESS

Companies are normally formed to carry out particular activities which will be specified in the "objects clause" of their respective memoranda of association. Therefore, in determining what constitutes a trade or business of a company, it is necessary to refer to the "objects clause" of its memorandum of association, to ascertain the activities that the company was registered to carry out. The carrying on of such activities will definitely constitute trade or business and the income therefrom will be subject to companies taxation in accordance with the provisions of the Act. Thus, a trade or business will include manufacturing and any other activities being carried on in pursuance of the goal for which the company was incorporated. Furthermore, in view of the fact that a company will pursue all possible activities to keep it in business, it is only reasonable to conclude that the income from all such activities constitute chargeable transactions and will therefore be taxed, except if they relate to capital items or are specifically exempted by other provisions of the Act. Neither the absence of a profit-making motive in particular transactions nor the fact that they are isolated and do not relate to the company's normal business could prevent the income from such transactions from being subjected to companies taxation.

6.4 DIVIDENDS

Tax is imposed on dividend income in Section 8 of CITA. The definition of dividend as given in subsection 3 of Section 8 of the Act is as follows:

(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 nominal 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 profits distributed, whether in money or money's worth or otherwise, other than those of a capital nature earned before or during the winding up or liquidation.

As in the taxation of individuals, the amount to be taken as the income of a company is the gross amount of the dividend and is deemed to arise on the day on which its payment becomes due.

The provisions of Section 15 CITA exempt certain dividends from tax. These are dividends:

(i) By a Nigerian company and satisfied by the issue of shares of the company paying the dividend (bonus shares); or

(ii) By a Nigerian company, out of any profits exempted from tax by any provision of the Act or by the fact that the company enjoys a pioneer status; or

(iii) Out of any profits chargeable to tax under the provisions of the Petroleum Profits Tax Act.

Part of the 1985 amendments to the Act is to the effect that dividends received from a Nigerian company are to be regarded as Franked Investment Income (FII).

The 1987 amendment also exempts from tax, dividend derived by a company from another company incorporated in Nigeria provided that the equity participation on which the dividend is payable is:

- Either wholly paid for in foreign currency or by asset brought into or imported into Nigeria.
- Brought or imported into Nigeria between 1 January 1987 and 31 December 1992.
- Not less than 10% of the equity share capital of the company paying the dividend.

For the purpose of this exemption, the tax free period starting from the year following that in which the new capital is brought into Nigeria shall be five years, if the company is in the agricultural trade or business, or is engaged in the petrochemicals or liquefied natural gas business. It shall be three years in any other case.

The amount of the withholding tax deducted in connection with any dividend due to a non-resident recipient shall be the final tax on those payments, that is, no further tax is payable by non-resident recipients of any dividend income (Section 16(a)).

6.4.1 Payment of dividend by a Nigerian Company

Where a dividend is paid out as profit on which no tax is payable due to: (1996 No.30)

(a) No total profits; or

(b) Total Profits which are less than the amount of dividend which is paid, whether or not the recipient of the dividend is a Nigerian Company, is paid by a Nigerian company, the company paying the dividend shall be charged to tax at the rate prescribed in subsection (1) of section 40 of this Act as if the dividend is the total profits of the company for the year of assessment to which the accounts, out of which the dividend is declared, relates.

6.4.2 Nigerian dividends received by companies other than Nigerian companies

In the case of a company which is neither a Nigerian company nor engaged in a trade or business in Nigeria at any time during a year of assessment:

(a) No tax shall be charged on it for that year in respect of any dividend received by it from a Nigerian company apart from tax withheld under section 80 of this Act;

(b) Where any dividend is paid out of profits on which no tax is payable due to no total profits or total profits which are less than the amount of dividend which is paid, whether the recipient of the dividend is a Nigerian company or not, the company paying the dividend shall be charged to tax at the rate prescribed in subsection (1) of section 40 of this Act as if such dividend is the total profits of the company for the year of assessment which relates to accounts out of which the dividend is declared;

(c) Nothing in this Act shall confer on such company or on the company paying the dividend, a right to repayment of tax paid by reason of the provisions if this section.

ILLUSTRATION 6.1

A company with Total profit of ₦140,000 for 2014 Assessment year, paid ₦250,000 dividend to its shareholders in respect of the 2013 financial statements which formed the basis for the assessment. The company will pay tax of ₦75,000 (30% of ₦250,000 assuming its turnover is more than ₦500,000) and not ₦42,000 (30% of ₦140,000) which would have been payable if the company did not declare the dividend.

6.5 AUTHORISED UNIT TRUST SCHEME

The provisions relating to Unit Trust Schemes are contained in Section 14A. The provisions of CITA shall, in respect of the income arising to the trustees of an authorised unit trust, have effect as if:

(a) the trustees were an investment company;
(b) the rights of the unit holders were shares in the company; and
(c) any income accruing to the trustees, available to be paid to the unit holders were dividends on such shares.

The profits of an authorised unit trust scheme, on which tax may be imposed shall be the income accruing to the trustees from all sources of the investment of the unit trust and deducting therefrom sums disbursed as management expenses, including remuneration for the managers.

The treatment of tax deducted at source is the same as is applicable to any other company taxable under CITA.

In this Section -

"authorised unit trust" - is defined as "a unit trust scheme that is authorised by the Commission under Section 576 of the Companies and Allied Matters Act 2004 as amended, to carry on the business of dealing in unit trust scheme;"

"unit trust scheme" - is defined as "any arrangement made 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 whatsoever;"

"unit holder" - is defined as "any investor, beneficiary or person who acquired units in a unit trust scheme and who is entitled to a share of the investments subject to the trusts of a unit trust scheme;"

"a trustee" - is defined as "the person in whom the property for the time being subject to any trust created in pursuance of the scheme is or may be invested (vested) in accordance with the terms of the trust.

6.6 EXEMPTIONS

Section 19 of CITA contains the list of profits or gains of companies or corporate bodies exempted from company taxation.

(a) Profits or incomes exempted in so far as they are not derived from trade or business being carried on:

(i) the profits of any company being a statutory or registered friendly society;

(ii) the profits of any company engaged in ecclesiastical, charitable or educational activities of a public character;

(iii) the profits of any company being a trade union, registered under the Trade Unions Act;

(iv) the profits of any company or corporation established by the law of a State for the purpose of fostering the economic development of that State;

(v) the profits of any company being a cooperative society, registered under any enactment or law relating to cooperative societies not being profits from any trade or business carried on by that company other than cooperative activities solely carried out with its members or from any share or other interest possessed by that company in a trade or business in Nigeria carried on by some other person or authority.

If any income in respect of the foregoing is derived from a trade or business. it is clear from the wordings of Section 19 that such shall become taxable.

(b) The following are also exempted from tax even if they are derived from trade or business being carried on by the bodies concerned:

(i) The profits of any company formed for the purposes of promoting sporting activities where such profits are wholly expendable for

such purpose, subject to such conditions as the Revenue Service may prescribe,

(ii) Dividend distributed by a Unit Trust,

(iii) Dividend derived by a company from another company incorporated in Nigeria, provided that:

- The equity participation of the recipient of the dividend in the company paying the dividend is either wholly paid for in foreign currency or by assets brought or imported into Nigeria between 1 January, 1987 and 31 December, 1992; and
- 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 the year in which the new capital is brought into Nigeria for the purpose of the trade or business in Nigeria of the company paying the dividend. If the company paying the dividend is in the agricultural trade or business, or is engaged in the petrochemicals or liquefied natural gas, the tax-free period shall be five years, while in any other case it is limited to three years.

(iv) The profits of any company engaged in petroleum operations within the meaning of Section 2 of the Petroleum Profits Tax Act in so far as those profits are derived from such operations and liable to tax under that Act. It should be noted that if any part of the profits of such company arises from other operations besides petroleum exploration, development and production and can therefore not be taxed under the Petroleum Profits Tax Act, such part is taxable under the Companies Income Tax Act.

(v) The profits of any company being a body corporate established by or under any Local Government Law or Edict in force in any State in Nigeria.

(vi) The profits of any body corporate being a purchasing authority established by an enactment and empowered to acquire any commodity, for export from Nigeria as well as from the purchase and sale of that commodity.

(vii) The profits of non-Nigerian companies which, but for this paragraph, would be chargeable to tax by reason solely of their being brought into or received in Nigeria.

(viii) Dividend, interest, rent or royalty derived by a company from a country outside Nigeria and brought into Nigeria through Government approved channels. “Government approved channels” means the Central Bank of Nigeria, any bank or other corporate body appointed by the Minister as

authorised dealer under the Second-Tier Foreign Exchange Market Act or any enactment replacing that act.

(ix) The interest on deposit accounts of a foreign non-resident company; provided that the deposits into the account are transfers wholly of foreign currencies to Nigeria on or after 1 January 1990, through Government approved channels.

(x) The interest on foreign currency domiciliary account in Nigeria accruing on or after 1 January 1990.

(xi) Dividend received from small companies in the manufacturing sector, in the first five years of their operation. Small companies are companies, with turnover of ₦1,000,000 and below, in an assessment year.

(xii) Dividend received from investments in wholly export-oriented businesses.

(xiii) The profits of any Nigerian company in respect of goods exported from Nigeria provided that the proceeds from such export are repatriated to Nigeria and are used exclusively for the purchase of raw materials, plants, equipment and spare parts.

(xiv) The profits of a company whose supplies are exclusively inputs to the manufacturing of products for export, provided, that the exporter shall give a certificate of purchase of the inputs of the exportable goods to the seller of the supplies.

In respect of all the foregoing, appropriate withholding taxes are deductible in accordance with the provisions of Sections 60, 61, 62 of CITA in spite of the fact of the exemptions of the gains or profits from income tax.

The National Council of Ministers (Federal Executive Council) may exempt by order:

- Any company or class of companies from all or any of the provision of the Act; or
- All or any profits of any company or class of companies from any source, on any ground which appears to it sufficient.

The National Council of Ministers may by order amend, add to or repeal any exemption, in so far as it affects a company.

The following notices and order shall continue in force for all purposes of the Act:

(a) The Income Exemption (interest on Nigerian Public Loans) Notice;

(b) The Income Tax Exemption (Nigerian Broadcasting Corporation) order;

(c) The Railway Loan (International Bank) (Exemption of Interest) Notice.

Interest on Loans – Agricultural Trade and Others

Interest payable on any loan granted by a bank on or after 1 January 1991 for the purposes of an agricultural trade or business shall be exempted from tax, provided that the moratorium is not less than 18 months and the rate of interest on the loan is not more than the base lending rate at the time the loan was obtained (Section 9(7)).

With effect from 1 January 1991, the requirements are:

(i) The moratorium is not to be less than 18 months and

(ii) The rate of interest on the loan is not to be more than the base lending rate at the time the loan was obtained.

"Base lending rate" means the weighted average of the cost of fund to any bank.

Agricultural trade or business is defined in the Act as any trade or business connected with:

(a) the establishment or management of plantations for the production of rubber, oil palm, coffee, tea and similar crops:

(b) the cultivation or production of cereal crops, tubers, fruits of all kinds, cotton, beans, groundnuts, sheanuts, beniseed, vegetables, pineapples, bananas and plantains

(c) animal husbandry, that is to say, poultry, piggery, cattle-rearing, fish farming, and deep sea fish-trawling.

Act 18 of 1998

Subsection 7 of Section 9 of the Act has been replaced with a new subsection 7 in Act 18 of 1998. The new subsection 7 is as follows:

Interest on any loan granted by a bank on or after 1 January 1997 to a company

(a) Engaged in –

  (i) Agricultural trade or business, or

  (ii) The fabrication of any local plant and machinery; or

(b) As working capital for any cottage industry established by the company under the Family Economic Advancement Programme (FEAP), shall be exempted from tax, provided

  (i) The moratorium is not less than eighteen months and

(ii) the rate of interest on the loan is not more than the base lending rate at the time the loan was granted."

Thus, the provisions relating to the loans granted to agricultural trade or business on or after 1 January 1991 are, with effect from 1 January 1997, extended to the trade or fabrication of local plant and machinery as well as Family Economic Advancement Programme (FEAP) cottage industry.

Interest on loan for export business

Interest accruing from loans granted by banks in aid of export activities is exempted from tax in accordance with the Table in Schedule 3 to the Act. The Table, which is the table of tax exemption on interest on foreign and other loans, is reproduced below:

Table of Tax Exemption on Interest on Foreign and other loans

	Repayment period Including moratorium	Grace period	% Tax Exemption Allowed
(i)	Above 7 years	Not less than 2 years	100%
(ii)	5-7 years	Not less than 18 months	70%
(iii)	2-4 years	Not less than 12 months	40%
(iv)	Below 2 years	Nil	Nil

The exemption is subject to the presentation of a certificate issued by the Nigerian Export Promotion Council stating that not less than 50% of a company's manufactured goods sold in the relevant accounting year were sold outside Nigeria and were not re-exported into Nigeria.

6.7 DETERMINATION OF PROFITS

For tax purposes, use is made of the accounts produced under the ordinary rules of accountancy, as it will be extremely difficult, if not impossible, to prepare new sets of accounts for tax purposes only. Besides the difficulties anticipated, there appears to be no justification for the unnecessary duplication of the efforts that would be required in the production of such accounts. It has been established in some decided cases, that in ascertaining the true profits of a trade for tax purposes, regard should be had to the correct principles of accountancy. Thus, in practice, adjustments that are considered necessary in view of the provisions of the Tax Acts, are made to accounting profits, to arrive at the profits for tax purposes. Such adjustments are usually in respect of:

(a) Expenditure charged but not allowable – disallowable expenditure;

(b) Items chargeable to tax but not credited in the Statement of Comprehensive Income (SCI);

(c) Items credited in the SCI but not taxable; and

(d) Expenditure not charged but allowable.

There are adequate provisions in the Act which when considered in the light of normal taxation practice, can be applied to determine which items of a company's trading transactions will fall into any of the four categories listed above and for which adjustments will be necessary. The main guiding principle is that of allowable and disallowable expenditure.

6.8 ALLOWABLE DEDUCTIONS

All expenses of a company that are wholly, exclusively, necessarily, and reasonably incurred in the production of the profits, are allowable deductions. Thus, any expense that can be proved to meet these conditions will be an allowable deduction in arriving at a company's chargeable profit unless such expense is specifically prohibited under any other provision of the Act.

In addition, the following items are stated in Section 20 of the Act, as allowable deductions provided they are incurred for the purpose of acquiring the profits being subjected to tax:

(a) Interest on money borrowed and employed as capital;

(b) Rent and premiums in respect of land or buildings occupied for the purpose of acquiring the profits;

(c) Repairs and renewal costs relating to the premises, plant, fixtures, etc., used in the business;

(d) Bad and doubtful debts to the extent that they are respectively estimated to the satisfaction of the Revenue Service to have become bad or doubtful of collection;

(e) Contributions to approved pension, provident or other retirement benefits fund, society or scheme;

(f) In the case of the Nigerian Railway Corporation, such deductions as are allowed under the provisions of the Authorised Deductions, (Nigerian Railway Corporation) Rules, 1959;

(g) Any outlay or expenses incurred during the year in respect of:

   (i) Salaries, wages or other remuneration paid to employees,

   (ii) Cost to the company of any benefit or allowance provided for the senior staff and executives which shall not exceed the limit of the amount prescribed by the collective agreement between the company and the employees and approved by the Federal Ministry of Employment, Labour and Productivity and the Productivity, Prices and Income Revenue Service as the case may be; and

   (iii) the expenses proved to the satisfaction of the Revenue Service 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.

(h) Section 22 allows for the deduction of the amount of reserve made out of profits for research and development subject to a ceiling of 10% of the total profits of the company before any deduction is made under this Section and Section 21 of the Act.

(i) Companies and other organisations engaged in research and development activities for commercialisation shall be allowed 20% investment tax credit on their qualifying expenditure for that purpose.

Rental charges

Rental charges in respect of residential accommodation occupied by employees of the company are allowed up to a maximum of 100% of the basic salary of employees.

Property Holding Companies

The allowable deductions are limited to:

(a) Expenses attributable to the maintenance of the property concerned; and

(b) Directors remuneration of up to ₦10,000 per annum per director payable to a maximum of three directors in any one company.

Repairs and renewals

The usual items under this heading are those expenses incurred in maintaining the earnings capacity of the assets of the company intact. In view of the fact that the keeping of such assets in good working condition is very essential for the company to acquire profits, costs connected with such exercise must, by reasonable expectation, be allowable deductions.

However, costs incurred in increasing the earning capacity of any fixed asset are capital in nature and therefore will not be allowable deductions. Repair expenditure on newly acquired fixed assets might not qualify as an allowable deduction particularly if large amount is involved and the expenditure is incurred to bring the asset into a usable condition after its acquisition. Such cost is to be considered as capital and should be added to the cost of acquisition of the asset. It is important to take note that repair costs are incurred for the purpose of maintaining the earning capacity of the asset and this implies that such asset must be in use in the business at the time that the repair work is carried out.

Bad and doubtful debts

The salient matters to note with regard to the treatment of bad and doubtful debts for tax purposes are as follows:

(a) They must relate to debts incurred in the ordinary course of the trade or business.
(b) They must be identifiable to specific debts. General reserves against bad and doubtful debts are not allowable deductions.
(c) Reserves no longer required are taxable (in the year that they are considered no longer necessary) if previously allowed.
(d) Debts previously written off, allowed in tax computation, and later recovered are taxable as income for the year in which recoveries are made.
(e) Necessary evidence must be provided at the request of the Revenue Service to prove that the debts have become bad or estimated to be doubtful of recovery.

ILLUSTRATION 6.2

The bad and doubtful debts account of a company for a year showed the following:

	₦		₦
Trade debts written off	13,000	Reserves b/f:	
Reserves c/f:		Specific	20,000
Specific	22,000	General	16,000
General	15,000	Charged to P&L A/C	14,000
	50,000		50,000

In the Statement of Comprehensive Income of this company, the sum of ₦14,000 will be shown as the charge for bad and doubtful debts for the year. How this sum has been arrived at can be reproduced in a statement form as follows:

		₦
Trade debts written off	(a)	13,000
Add: Increase in specific provision (₦22,000 – ₦20,000)	(b)	2,000
		15,000
Less: reduction in general provision (₦16,000 –₦15,000)	(c)	(1,000)
Charged in profit and loss account		**14,000**

It will be easier from this statement to determine which amount should be adjusted for, in the tax computation in respect of this company's bad and doubtful debts charge, as follows:

(a) This will be an allowable charge as the amount written off is in respect of specific debts.
(b) The increase will also be allowable as the amount involved is also in respect of specific debts.
(c) The general provision would have previously been disallowed when created. Any subsequent release of this sort of provision cannot be taxable

as it had never been allowed. Thus, the accounting profit will be reduced by the amount of the reduction in the general provision, resulting in a lower taxable profit than the accounting profit.

The only adjustment necessary in respect of the foregoing is a deduction of the sum of ₦1,000 in respect of (c) above from the accounting profit to arrive at the taxable profit of the company.

Thus, if a specific reserve for bad debts increases or decreases, no adjustment is necessary to the accounting profit, but in case of general reserve appropriate adjustment will need to be put through.

Donations

CITA Section 21 stipulates, among other things, the conditions to be satisfied before any donation can be allowed. These are:

(a) Donations must be made out of the profits of the company (Section 21(2). Thus if a company makes a loss, whatever donations paid during that year should not be treated as allowable.

(b) Donations should not be expenditure of a capital nature.

(c) For any year of assessment, the maximum amount allowable is limited to 10% of the total profits of the company before deducting the donations.

(d) The donation must be made to any of the approved bodies.

NB: Following the provisions of the Companies Income Tax (Amendment) Act 2007, Donations (whether of a revenue or Capital nature) made in respect of University and other Tertiary or Research institutions for research or any developmental purpose, or as an endowment out of profits of the period by a Company, shall not exceed an amount which is equal to 15% of the Total Profits or 25% of the Tax payable in the year of the donation, whichever is higher.

The Fifth Schedule to CITA which contains the list of the approved bodies, etc, to which donations may be made is reproduced below with necessary grouping to facilitate commitment to memory by readers. Donation to anybody or institution whose name is not included on the list will not be an allowable deduction.

FIFTH SCHEDULE (Section 21)

Funds, Bodies and Institutions in Nigeria to which donations may be made under Section 21 of the Act are:

Youths/Philanthropic Organisations

(a) The Boys Brigade of Nigeria.

(b) The Boys Scouts of Nigeria.

(c) The Girls Guides of Nigeria.

(d) The Nigerian Red Cross.

(e) The National Youth Council of Nigeria.

(f) The Nigerian Youth Trust.

Religious

(a) The Christian Council of Nigeria.

(c) Islamic Education Trust.

Medical

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 a society or association otherwise than for the purpose of profits or gains, to the individual members of that society or association.

Educational

(a) Any educational institution affiliated under any law with any University in Nigeria or established under any law in Nigeria and any other educational institution recognised by any Government in Nigeria.

(b) The Institute of Medical Laboratory Technology.

(c) The National Library.

(d) A public fund established and maintained exclusively for providing money for the acquisition, construction, maintenance or equipping a building used or to be used as a school or college by the Government of the Federation or a state or by a 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 that society or association.

(e) The National Braille Library of Nigeria.

(f) Van Leer Nigerian Educational Trust.

(g) The Institute of Chartered Accountants of Nigeria Building Fund.

(h) Nigerian Accounting Standards Revenue Service.

(i) Paterson Zochonis Nigeria Technical Education Trust Fund.

(j) Educational Cooperative Society.

Relief funds

(a) National Commission for Rehabilitation.

(b) A public fund established and maintained for providing money for the construction or maintenance of a public memorial relating to the civil war in Nigeria which ended on 15 January, 1970.

(c) Southern Africa Relief Fund.

(d) Any public fund established or approved by the Government of the Federation or any of the State Governments in aid of or for the relief of drought or any other national disaster in any part of the Federation.

Research

(a) The Cocoa Research Institute of Nigeria

(b) The National Council for Medical Research

(c) The National Science and Technology Development Agency

(d) The Nigerian Institute for International Affairs

(e) The Nigerian Institute for Oil Palm Research

(f) The Nigerian Institute for Trypanosomiasis Research

(g) National Science and Technology Fund.

Welfare

(a) A public institution or public fund (including the Armed Forces Comfort Fund) established or maintained for the comfort, recreation or welfare of members of the Nigerian Army, Navy or Air Force

(b) National Sports Commission and its State Associations

(c) The Nigerian Society for the Deaf and Dumb

(d) The Society for the Blind

(e) The Nigerian National Advisory Council for the Blind

(f) Associations or Societies for the Blind in Nigeria

(g) Training Centres and Residential Schools for the Blind in Nigeria

(h) Rotary International (Polioplus programme)

(i) The Musical Society of Nigeria.

Foundations/Endowment Fund

(a) Kewalram Chanrai Foundation Limited

(b) Afprint Foundation Limited

(c) University College Hospital Endowment Fund

Others

(a) The Nigerian Museum

(b) Nigerian Conservation Fund

References to donations made by a company do not include any payments made by the company for valuable consideration.

Research and Development

The allowability of amounts relating to research and development are in two Sections of the Act.

Section 20(g)(iii) allows expenses proved to the satisfaction of the Revenue Service 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.

Section 22 allows the deduction of amount of reserves made out of the profits of that period by a company for research and development. The deduction to be allowed under this Section for any year of assessment shall not exceed 10% of the total profits of the company for that year as ascertained before any deduction is made under this Section and Section 21 (deductible donations) of the Act.

The effect of these two Sections can be summarised thus:

(a) Actual expenditure on research and development are allowable deductions in accordance with the provisions of Section 20.

(b) Reserve made out of profits for research and development expenditure are allowed as a deduction from profit subject to the ceiling fixed.

One thing to be noted though is that a company cannot make the deduction twice. If the deduction was made when the reserve was made, such cannot be deducted again when the actual expenditure is incurred.

In addition, subsection 3 of Section 22 provides for 20% investment tax credit on the qualifying expenditure of companies and other organisations engaged in research and development activities for commercialisation once the expenditure are incurred for that purpose.

6.9 DISALLOWABLE EXPENDITURE

Certain expenditure are disallowed for tax purposes. These are specifically listed in Section 23 of the Act and they should be added back to accounting profit even if their charge in the profit and loss account could be justified under ordinary rules of commercial accountancy. These are:

(a) Capital repaid or withdrawn and any expenditure of a capital nature;

(b) Any sum recoverable under an insurance or contract of indemnity;

(c) Taxes on income or profits levied in Nigeria or elsewhere. In case of tax levied outside Nigeria on profits which are also chargeable to tax in Nigeria and double taxation relief is not available, such tax will be an allowable deduction;

(d) Payments to unapproved pension, provident, savings or widows and orphans society, fund or schemes;

(e) Depreciation of any asset; (capital allowances are granted instead);

(f) All appropriations for profit; namely, dividends; general provision for bad and doubtful debts; write off of preliminary and formation expenses and expenses on issue or redemption of shares and other securities, etc.;

Pre-production expenses to the extent to which they are not of capital nature will be allowable deduction as such have been incurred for the purpose of producing the company's profit.

(g) Any expense of any description incurred within or outside Nigeria for the purpose of earning management fee unless prior approval of an agreement giving rise to such management fee has been obtained from the Minister;

(h) Any expense whatsoever incurred within or outside Nigeria as management fee under any agreement entered into after the commencement of this Section except to the extent as the Minister may allow; and

(i) Any expense of any description incurred outside Nigeria for and on behalf of any company except of a nature and to the extent as the Revenue Service may consider allowable.

Treatment of Assets Impairment

The present tax laws have not been amended to consider issues relating to the treatment of impairment of receivables, tangible and intangible assets with respect to International Financial Reporting Standards (IFRS).

Therefore, the debit to Statement of Comprehensive Income |(SCI) is not yet allowable for tax purposes as it is not yet consumed.
All impairment losses (under IAS 36) charged to the SCI should not be allowed for tax purpose.

6.10 WAIVER OR REFUND OF LIABILITY OR EXPENSE

Where the liability for an allowed expense is subsequently waived or released or a refund is received for the amount paid, the amount which is so waived, released, or refunded is deemed to be the income of the company in the year in which the waiver, release or a refund is made or given. Similar provision is applicable in personal taxation practice.

It should be noted that where a waiver of a non-revenue item, for example, a loan is in favour of a company, such an amount shall only be subjected to Capital Gains Tax (CGT) if applicable, NOT Income Tax, as the liability had not been previously treated as an allowed expense. If no CGT is due, such a waiver cannot be subject to tax.

6.11 BASIS OF ASSESSMENT

As earlier stated, the income tax year which is called an assessment year is the Government's financial or fiscal year. It runs from 1 January to 31 December of every year. (It was from 1 April to 31 March following, up to 31 March 1980). A company's accounting year will be related to the Government's year in which the operating result of such company is to be assessed to tax. An accounting period which is related to any particular assessment year is usually referred to as the "basis period" of that assessment year.
The general rules for determining basis period of assessments are contained in Section 25 of CITA.

The assessable profits of any company for each year of assessment, shall be the profits of the year immediately preceding the assessment year. This is referred to as the preceding year basis of assessment. Assessable profit as defined in CITA, is usually the accounting profit of the company as adjusted for tax purposes, that is, the adjusted profit that will be arrived at before reflecting the effect of any loss relief, balancing charge and or capital allowances.

Where a company's accounting year coincides with the Government fiscal year (assessment year) it is the accounting year ending within the preceding Government fiscal year that is taken as the preceding year. Where the accounting year of a company does not coincide with an assessment year, it is the profit of the accounting year ending on any day in the preceding assessment year that is taken to be the profit of the preceding assessment year.

ILLUSTRATION 6.3

Consider the cases of two companies making up their yearly accounts, one to 31 December and the other to 30 September, respectively. The years of assessment and relevant basis periods will be as follows:

	BASIS PERIOD	
	(A)	(B)
Assessment Year	Where accounts are made up to 31 December	Where accounts are made up to 30 June
2011	A/cs. for y/e 31/12/2010	A/cs. for y/e 30/9/2010
2012	A/cs. for y/e 31/12/2011	A/cs. for y/e 30/9/2011
2013	A/cs. for y/e 31/12/2012	A/cs. for y/e 30/9/2012
2014	A/cs. for y/e 31/12/2013	A/cs. for y/e 30/9/2013

Note that in (A) the basis periods coincide with the preceding Government fiscal years, since the accounting years of the company coincide with the Government accounting years. In (B), the company's accounting years do not coincide with

the Government accounting years, nevertheless each of the company's accounting years ending on a date in each of the preceding government accounting years is used.

This will be the position, for as long as the companies continue to prepare their accounts to cover periods of twelve months, ending on those dates. However, exemptions to this rule are:

(a) On commencement of a new trade – first three assessment years
(b) On cessation of trade – last two assessment years
(c) On a permanent change in accounting date – the year of change and the two assessment years following.

The applicable procedures are summarised below:

New trade or business

First assessment year – Profit from date of commencement to the 31 December following:

Second assessment year – Profit of the first twelve months of operation.

Third assessment year – Profit of the preceding assessment year, that is the preceding year basis. If no twelve-month accounts have been prepared to end on a date in the preceding assessment year, the second year's assessment is repeated as the assessment for the third year.

For the fourth and subsequent years, the preceding year basis rule will apply.

It should also be noted that election can be made by the taxpayer, that is the company, to have the assessments for the second and third years based on the actual results for those years. The manner of making this election and applicable time limits are the same for both personal and companies taxation.

ILLUSTRATION 6.4

Mr. Oluwalogbon established Goldmine Fisheries Limited in 1991 for the purpose of commercial fish production. The company commenced business on 1 January 1992. Its accounting date is 31 December each year while its adjusted profits for the first ten years are as follows:

Trading Periods	Adjusted profits/(losses)
	₦
Year ended 31/12/92	(100,000)
Year ended 31/12/93	30,000
Year ended 31/12/94	25,000
Year ended 31/12/95	20,000
Year ended 31/12/96	15,000

	₦
Year ended 31/12/97	35,000
Year ended 31/12/98	50,000
Year ended 31/12/99	(40,000)
Year ended 31/12/00	35,000
Year ended 31/12/01	30,000

Required:
Compute the Assessable profits for the relevant years.

SUGGESTED SOLUTION 6.4

YOA		Basis Period Assessable	Assessable Profits
		₦	₦
1992	01/01/92 – 31/12/92 - Actual		
	Loss for year ended 31/12/92	(100,000)	NIL
	Loss c/f to 1993	(100,000)	
1993	1st 12 months - 01/01/92 – 31/12/92	(100,000)	
	Loss b/f from 1992	(100,000)	
	Loss c/f to 1994 restricted		
	to actual loss sustained	(100,000)	NIL
1994	Preceding year basis - 01/01/93 – 31/12/93		
	Profit for year ended 31/12/93	30,000	
	Loss b/f from 1993	(100,000)	
	Loss c/f to 1995	(70,000)	NIL
1995	Preceding year basis-01/01/94–31/12/94		
	Profit for year ended 31/12/94	25,000	
	Loss b/f from 1994	(70,000)	
	Loss c/f to 1996	(45,000)	NIL
1996	Preceding year basis		
	Profit for year ended 31/12/95	20,000	
	Loss b/f from 1995	(45,000)	
	Loss c/f to 1997	(25,000)	NIL
1997	Preceding year basis		
	Profit for year ended 31/12/96	15,000	
	Loss b/f from 1996	(25,000)	
	Loss c/f to 1998	(10,000)	NIL

		₦	₦
1998	Preceding year basis		
	Profit for year ended 31/12/97	35,000	
	Loss b/f from 1997	(10,000)	25,000
1999	Preceding year basis		
	Profit for year ended 31/12/98	50,000	50,000
2000	Preceding year basis		
	Loss for year ended 31/12/99	(40,000)	
	Loss c/f to 2001	(40,000)	NIL
2001	Preceding year basis		
	Profit for year ended 31/12/00	35,000	
	Loss b/f from 2000	(40,000)	
	Loss c/f to 2002	(5,000)	NIL
2002	Preceding year basis		
	Profit for year ended 31/12/2001	30,000	
	Loss b/f from 2001	(5,000)	25,000

Notes:

(a) Goldmine Fisheries Limited is allowed to carry forward unrelieved losses indefinitely and recoup same against future profits.

(b) Readers were not required to compute the tax liability as it is the computation of assessable profits that was required in the question.

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 received or paid on the date of cessation.

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

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:

(a) The year of assessment in which the change occurs; and
(b) The two years of assessment following.

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 6.5

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 Revenue Service 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 Revenue Service 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 minimise the assessable profits on which tax is payable for those periods. The following information were provided:

	₦
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
	₦	₦	₦	₦
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 6.5

Format Construction Nigeria Limited

The profits presented shall be adjusted for tax purposes

	1992	1993	1994	1995
	₦	₦	₦	₦
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 officials will compute as they deem fit the assessments for 1994 (the year of change), and 1995, 1996 (the two years following).

On the basis of June, as the new accounting date:

Alternative 1: Old Accounting Date, 31/12

		₦
1994	1/1/93 to 31/12/93	550,000
1995	1/1/94 to 31/12/94	660,000
1996	1/1/95 to 31/12/95	770,000

Alternative 2: New Accounting Date, 30/6

1994	1/7/92 to 30/6/93	6/12 x 220,000 + 6/12 x 550,000 =	385,000
1995	1/7/94 to 30/6/94	6/12 x 550,000 + 6/12 x 660,000 =	605,000
1996	1/7/94 to 30/6/95	6/12 x 660,000 + 6/12 x 770,000 =	715,000

Revenue compares the two, as follows:

Assessment Year	Old 31/12	New 30/6
	₦	₦
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:

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

On the basis of 30 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
1994 1/10/92 to 30/9/93 3/12 x 220,000 + 9/12 x 550,000 = ₦467,500
1995 1/10/94 to 30/9/94 3/12 x 550,000 + 9/12 x 660,000 = ₦632,500
1996 1/10/94 to 30/9/95 3/12 x 660,000 + 9/12 x 770,000 = ₦742,500
Revenue compares the two, thus:

Assessment Year	Old 31/12	New 30/9
	₦	₦
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

Revenue chooses the alternative that produces the higher assessable profits, that is the assessments for the three years are based on the accounting date of 31 December:

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

Explanatory Note

Irrespective of whether the accounting date is June or September, the Revenue's option will produce the higher assessable profits and shall be that based on a 31 December accounting date. Thus, whether the company prepares the accounts for the year ending within 1994, to end in June 1994 or September 1994 will have no effect on the assessable profits for the years of assessment involved as it is the Revenue that has the option to make the election.

6.12 COMPANY IN PARTNERSHIP WITH ANOTHER

Where a company is engaged in a trade or business with any other person in Nigeria, that trade or business shall be deemed to constitute a separate source of profits, and the Assessable profits of the company from that source shall be determined under the provisions of the Personal Income Tax Act, 2004 (as amended) in like manner as would be the assessable income of any individual partner in that partnership – CITA Section 25(8).

In effect, the taxation rules for determining the incomes of a partner in a partnership are the same whether the partners therein are individuals or companies.

6.13 TOTAL PROFITS AND SOURCES OF PROFITS

The Total profit of any 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 thereto of the amount of balancing charge that may be applicable less deductions due for loss relief, investment allowance and capital allowance. This is the substance of the definition of total profits as given in subsection 1 of Section 27 of CITA.

The components of this definition which should be noted are: assessable profits from all sources; loss relief; capital allowances including investment allowances and balancing charge. Assessable profit as treated in this chapter is the accounting profit as adjusted for tax purposes but before having regard to any loss relief, capital allowances or balancing charge. Loss relief is considered in the next subparagraph of this chapter while investment and capital allowances as well as balancing charge are discussed elsewhere in this study pack. The reference to "profits from all sources" will now be discussed.

The definition of sources was not given anywhere in CITA. It is therefore uncertain how the business activities of each company are to be grouped for this purpose. The Federal Inland Revenue Service had in 1985 issued a circular in which there was a reference to what "sources" could mean. In that circular, examples of sources of profits were given as:

"manufacturing of goods up to disposal of such goods, road construction, building construction, road transport, credit financing, equipment leasing, leasing of immovable property, investment in stock and shares".

Examples also given in the same circular in the case of an insurance company's sources of profits are:
"...group life, industrial life, ordinary life endowment, all risks, motor vehicle, fire, marine, workmen compensation, investment of funds...".

The rationale behind this classification is unknown and it is uncertain whether it will be acceptable to the general business community. Whether or not an acceptable classification is produced the most important thing to note is that each company might be required to produce separate profit and loss account for each separate activity that can be regarded as unrelated to the other ones.

This is with a view to being able to determine whether there are losses from particular sources which should not be aggregated with profits from other sources for the purpose of arriving at the total profits of the company. It is certain that producing such separate profit and loss accounts could be very cumbersome for companies having several lines of business activities; for example, UAC of Nigeria PLC and other conglomerates. Furthermore, the method of apportionment of joint costs or overheads of the company to arrive at the profit or loss from each source would need to be specified by the Revenue Service.

Perhaps CITA might need an amendment to incorporate the definition of the various sources and how the profit or loss from each source is to be determined vis-a-vis the apportionment of joint costs. The enactment of legislation dealing with group relief would also go to a large extent in eliminating the practical difficulties inherent in the existing provisions of CITA.

Decided Case

The position of the court in a recently decided case would shed further light on this issue of sources of profit. It is also a confirmation that taxpayers are free to challenge information in the Revenue's Circular that are not strictly in accordance with tax statutes.

The case, Federal Inland Revenue Service v. American International Assurance Company (Nig.) Plc was decided in favour of the company. The issue was whether within the context of CITA Section 14, life insurance and non-life insurance are one trade or business or two separate trades or businesses. The court held that it cannot be said that the company carrying on both life and non-life insurance businesses are carrying on two separate businesses for the purpose of Companies Income Tax Act. The company was said to be engaged in only one trade or business.
The requirement of Section 27(1) is that the assessable profits from all sources are to be aggregated. If a loss has been incurred from any one source, such cannot be aggregated with the profits from other sources to determine total profits. Such loss is to be carried forward for relief against future profits from the same source. Additions and deductions are then made for balancing charge and investment and capital allowances respectively to arrive at total profits.

When the total profits have been arrived at, the tax rate (presently 30%) is applied on the total profits to arrive at the tax payable.

ILLUSTRATION 6.6

Consider a hypothetical company with the respective figures and three sources of profits for an assessment year as shown below:

		Total of assessable profits	Losses carried forward
(a)	Trade profit	1,000	
	Trade losses brought forward	-	
		1,000	
(b)	Property income	400	
	Less losses of the same source brought forward	(600)	
	Unrelieved loss	-	(200)
(c)	Interest income	300	
	Total of Assessable profit (a) + (c)	1,300	
	Add balancing charge	200	
		1,500	
	Deduct		
	Investment allowance	-	
	Capital allowances	350	
	Total profit	1,150	

It is on these Total Profits that the tax rate will be applied, to arrive at the amount of tax payable. For example, the tax payable in the ILLUSTRATION above with a tax rate of 30% is ₦345, that is, 30% of ₦1,150. The 200 unrelieved loss from the property income source will be carried forward for relief against future profit from the same source; it cannot be set off against the ₦1,150 total profits.

Order of giving effect to Section 27(1)

The wordings of Section 27(1), regarding total profits of a company for any year of assessment can be interpreted and broken down into stages as follows-

Stage 1. Aggregate all assessable profits from all sources

Stage 2. To the total of the assessable profits from all sources
Add: Any balancing charge

Stage 3. Deduct
Any amount of loss relief due

Stage 4. And also deduct
Any investment and capital allowance to be granted.

From the Illustration above, it is clear that these stages cannot be strictly adhered to as the effect of loss relief (stage 3) had to be shown in stage 1 to ensure that only the net assessable profits from each source are aggregated. Furthermore, the effect of any balancing charge as well as investment and capital allowances should also have been shown against the respective source where the relevant fixed assets had been employed. For example, it would appear ridiculous deducting capital allowances from interest income where no qualifying expenditure had been incurred for the purpose of earning such income.

Perhaps the aggregation which is in stage 1 should in fact be in stage 4, after the exercise in the other three stages would have been performed for each source of assessable profits wherever applicable and this is the treatment that is recommended.

It should be noted that the capital allowances restriction will still be applicable for any capital allowances to be deducted in computing total profits.

6.14 LOSSES

In arriving at the chargeable profits of a company, losses, if any, incurred in the preceding year of assessment are to be deducted. Contrary to what obtains in personal taxation, there is no current year loss relief available to companies. It is only the carry forward relief that is available.

Section 27 of the Act contains the provisions applicable to losses incurred by companies. Essentially, these are:

(a) The amount of the loss to be allowed should be that which the Revenue Service is satisfied as having been incurred by the company in a trade or business during a preceding year of assessment (Section 27(2)(a)). The reference to preceding year in the wordings of that Section of CITA emphasises that current year relief is not available for losses incurred by companies;
(b) In no circumstance shall the amount to be relieved exceed the total amount of the loss;
(c) Relief can only be against profits from the same trade or business in which the loss was incurred;
(d) With effect from 2007, losses can be carried forward indefinitely and relieved against future profits; and
(e) The loss available for relief should be computed on the same basis as that of assessable profit, for a year of assessment.

Terminal Loss Relief

There is no provision in the Act for the granting of relief for losses by a company in the year of assessment when its trade or business permanently ceases. Thus, there is no relief for any loss incurred in the last year of trade nor for any unrelieved loss accumulated up to the date of cessation.

The computation of the assessable income for the year of cessation will be on actual basis. Since a loss has been incurred for this period, assessment will be nil, for the assessment year concerned. However, there are provisions for the relief of unutilised capital allowances at the time of permanent cessation of a company's trade. Such capital allowances can be carried back to be relieved against the assessable profits of the preceding years up to the fifth year before the year of cessation (Sch. 2 para. 24(5)).

6.15 NORMAL COMPANY TAX RATE

For each year of assessment, tax is payable at the current rate of 30% of the total profits of every company; Section 29(1). The current rate of 30% was introduced from the 1996 assessment year. The rate can be altered at any time upon the passing of the appropriate legislation.
The total profits for any year of assessment has already been discussed.

Tertiary Education Tax will be payable at 2% of assessable profit. The assessable profit of a company must be known, before it's Tertiary Education tax liability can be computed.

Minimum Tax [Section S33 (1), (2)]

Where in any year of assessment, the ascertainment of total assessable profits from all sources of a company results in:

(a) A loss; or

(b) No tax payable; or

(c) Tax payable which is less than the minimum tax, the tax payable by the company shall be the minimum tax computed as follows:

 (i) Where turnover is ₦500,000 or below and the company has been in business for at least four calendar years:

  - 0.5% of gross profits; or
  - 0.5% of net assets; or
  - 0.25% of paid up capital; or
  - 0.25% of the turnover

  whichever is the highest.

 (ii) Where turnover is higher than ₦500,000

  Whatever is payable as computed in A above plus 0.125% of turnover in excess of ₦500,000.

In accordance with Section 33 of CITA, the Minimum Assessments provisions do not apply to:

(i) A company carrying on agricultural trade or business [S.33 (9)]

(ii) A company with at least 25% imported equity capital [S.33(3b)]; and

(iii) Any company for the first four calendar years of its commencement of business.

For any year of assessment when minimum tax is payable, the capital allowances due for that year will still be computed and relieved as much as possible from the assessable profits of the year as if the tax payable is based on the assessable profits. Whatever capital allowances that cannot be relieved due to insufficiency of assessable profits can be carried forward to subsequent assessment years. The implication of this provision is that taxpayers will lose the capital allowances that could be relieved against the assessable profits regardless of the fact that the tax is not based on that assessable profits but on turnover, and so on, which will be the case when the minimum tax provisions are being applied. A way out is by not making a claim for capital allowance.

6.16 TERTIARY EDUCATION TAX

Enabling Law and Imposition of Education Tax

Education Tax was first introduced in Nigeria in 1993 with the enactment of the Education Tax Decree No 7 of 1993. The Act is currently known as Tertiary Education Trust Fund (Establishment Act 2011).

Education tax is payable on an annual basis by every registered company in Nigeria that is liable to tax under the Companies Income Tax Act and Petroleum Profits Tax Act. The rate of the tax is 2% of the assessable profit. By inference, a company, which has an adjusted/assessable loss, will not be liable to Education Tax.

Administration of Tertiary Education Tax

The Federal Inland Revenue Service (FIRS) shall assess and collect tertiary education tax from Companies. When the FIRS is assessing a company for either Income Tax or/and Petroleum Profits Tax, it is required to simultaneously raise the education tax assessment on such company. The tax is payable within 60 days after the Revenue Service has served notice of assessment on a company and the Revenue Service is empowered by the Act to devise such forms, as it may deem necessary, for the purpose of assessing and collecting the tax. At the moment, a taxpayer is expected to file Self Assessment form for Tertiary Education Tax at the time of filing its Company Tax Returns.

Establishment of the Tertiary Education Fund & Revenue Service of Trustees

For the proper management and administration of education tax and education fund, a Revenue Service of Trustees was established.

The Revenue authority is expected to pay into the fund the tax collected under the Act and shall when doing so, submit to the Revenue Service of Trustees a return showing the names of the companies making the payment; the amount collected; the assessable profit of the companies for the accounting period; and such other information as may be required by the Revenue Service of Trustees.

The Revenue Service of Trustees is expected to administer and disburse the amount in the fund to Federal, State and Local Governments, Educational Institutions, including Primary and Secondary Schools but excluding Private Institutions. The amount in the fund is meant for the following:

(a) Rehabilitation, restoration and consolidation of education in Nigeria
(b) Works centers and prototype development
(c) Staff development and conference attendance
(d) Library system at the different levels of education
(e) Research equipment procurement and maintenance
(f) Higher education book development fund
(g) Redressing any imbalance in enrolment mix as between the higher educational institutions.
(h) Execution of the nine-year compulsory education programme.

The Revenue Service of Trustees shall consist of:

(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.
(d) The Executive Secretary.

The Membership of the Revenue Service of Trustees shall reflect the Six Geo-Political zones of the Federation.

The members of the Revenue Service of Trustees shall:

(a) Be appointed by the President.
(b) Be persons with considerable experience from the public and private sectors to represent the business, financial and education sectors.

(c) Hold office for a term of four years and may be eligible for reappointment for a further term of four years and no more.

(d) Be paid such remuneration and allowances, as the President may from time to time determine.

Functions of the Revenue Service of Trustees

The Revenue Service shall have responsibility to:

(a) Monitor and ensure collection of the 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 and/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 the Federal Government on its activities and prepare annual audited reports;

(i) Review progress and suggest improvement within the provisions of the Decree; and

(j) Do such other things as are necessary or incidental to the objects of the fund or as may be assigned by the Federal Government.

The Revenue Service of Trustees shall administer, manage and disburse the tax imposed on the basis of:

(a) Equality among the six geo-political zones of the Federation.

(b) Equality among the states within a zone.

(c) Equality among the local governments or area councils within a state or the Federal Capital Territory, Abuja respectively.

Appointment of the Executive Secretary of the Fund

There shall be for the fund an Executive Secretary who shall:

(a) Be appointed by the President on the recommendation of the Minister of Education.

(b) Be a person with good knowledge in administrative matters.

(c) Be the chief executive and accounting officer of the fund.

(d) Have such qualifications and experiences as are appropriate for a person required to perform the functions of that office.

(e) Hold office for a period of 5 years and may be eligible for reappointment for a further term of 5 years and no more.

The executive secretary shall, subject to the general direction of the Revenue Service of Trustees, be responsible:

(a) For the day to day administration of the fund.

(b) For keeping the books and proper records of the proceedings of the Revenue Service of Trustees.

(c) For the administration of the secretariat of the Revenue Service of Trustees.

(d) For the general direction and control of all other employees of the fund.

ILLUSTRATION 6.7

Doroman Limited extract of operating results per Audited Financial Statements for the year ending 31 October 2013 is as follows:

	₦'000
Operating Profit	1,490
Depreciation Provision	610
Interest on borrowed fund	412
Provision for General Debts	390
Balancing Allowance	290
Balancing Charge	220
Stamp Duty on Increase in Capital	180
Capital Allowances agreed	610

Required:

Compute Assessable Profit and Education tax for the relevant year of assessment.

SUGGESTED SOLUTION 6.7

DOROMAN LIMITED

Computation of Adjusted Profit & Tertiary Education Tax for 2014 Assessment

	₦'000	₦'000
Operating Profit per 2013		
Audited Accounts		1,490
Add Back Disallowable Expenses		
Depreciation	610	
General Bad Debts Provision	390	
Stamp Duty on Increase	180	1,180
Add Balancing Charge		220
Assessable Profit		**2,890**
Education Tax Liability @ 2% of ₦2,890		57.8

NB:

Assuming Doroman Limited made a loss of ₦1.550m, this will result in adjusted loss of ₦150,000 (i.e. 1,550 - 1,180 - 220). The Company is therefore not liable to Education Tax assessment in 2014.

6.18 SMALL BUSINESS RATE

Certain companies referred to as Small Business with turnover of ₦1,000,000 (one million Naira) and below in the year of assessment shall be charged a lower rate of tax of 20% for five years from the commencement of the business. [Section 40(6)].

The lower rate will be applicable only to companies engaged in the business of:

(a) manufacturing, or

(b) agricultural production, or

(c) mining of solid minerals, or

(d) wholly export trade.

If it is assumed that a company is a manufacturer of certain goods and that the turnover in respect of the 2013 assessment year was ₦991,000 with profits of ₦250,000. The tax payable shall be 20% of ₦250,000 that is, ₦50,000. In order to determine the rate of tax that should be applied to any company therefore, the nature of the business being carried on, as well as the turnover of the company in the assessment year, will need to be considered.

Furthermore, the ₦1,000,000 turnover limit, must not be exceeded, if the lower tax rate is to be applied.

It should be noted that small business rate was applicable with effect from the assessment years 1988; 1989; and 1990 for companies in operation before 1 January, 1988. The turnover limit then was ₦500,000. Act No. 3 of 1993 provides for an extension of this benefit for an additional two years where the company shows evidence of good records and management and remained in the same line of business.

The turnover limit is now ₦1,000,000 for each assessment year, while the rate can be applied for the first five Assessment years provided the annual turnover still qualifies the business.

6.19 PRE-OPERATION LEVY

A company which is yet to commence business after at least 6 months of incorporation shall, for each year it obtains a tax clearance certificate pay a levy of:

(a) ₦25,000 for the first year; and

(b) ₦20,000 for every subsequent year.

6.20 INFORMATION TECHNOLOGY

Information Technology Tax is governed by the National Information Technology Development Act (NITDA) 2007. According to Section 12(2a) of the Act, Information Technology tax is payable by specified companies with turnover of ₦100 million and above. The tax is 1% of Profit before tax and is assessed by the FIRS. The tax when paid is tax deductable for Company Income tax purposes.

IT tax is assessed by FIRS and is payable within 60 days of service of a notice of assessments – Section 16(3). Penalty for non compliance as stated in Section 16(4) of the Act is 2% of the tax payable.

Entities liable to IT tax as stated in Schedule III of the Act are:

(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; and

(e) Insurance Companies.

6.21 WITHHOLDING TAX

6.21.1 Introduction

Withholding Tax (WHT) is an advance payment of tax, which is deducted at source on certain transactions and later applied, where it is not a final tax, as tax credit in the settlement of the income tax liability of the year to which the payment that suffered the deduction relates.

Arising from this definition are the following peculiarities of the tax:

(a) Withholding Tax is a deduction at source, which gives the taxpayer no option as to whether to pay it, or not.

(b) Withholding Tax is an advance payment in lieu of the income tax to be paid later. This means that it is not a separate tax.

(c) Withholding Tax being an advance payment of income tax cannot be used later as credit for any other tax such as Education Tax or Value Added Tax.

(d) Some withholding taxes are regarded as final tax. Where this is so, the income from which they have been deducted can no longer be brought into account for tax purposes.

(e) As Withholding Tax is to be utilised as credit for the income tax liability of the year to which the income relates, it means that one cannot use it to settle back year or future year tax liabilities, until the account of the year to which the WHT relates has been finalised, and tax fully settled with the withholding or part thereof, still remaining unutilised.

Withholding tax as a collection device, was introduced in a limited form by the CITA and later expanded in terms of coverage.

6.21.2 Enabling Laws

Sections 68, 69, 70, 71 & 72 of Personal Income Tax Act LFN 2004 (as amended) deal respectively with Withholding Tax deductions from rent, interest or royalties, dividends and directors fees paid to individuals. On the other hand, section 78 - 81 CAP 60 LFN 2004 (as amended) deal respectively with deductions from interests, rent and dividends paid to corporate bodies. Sections of PITA and CITA deal with deductions of tax at source in general. It is under these sections that the application of Withholding Tax could be widened to include building contracts, contract supplies, consultancy and professional services, which are not specifically mentioned in the CITA.

6.21.3 Withholding Tax Rates, Remittances and Tax Authorities

Taxes are to be withheld from corporate bodies and individuals at the rate listed in the table below and remitted to the relevant tax authority within 30 days in the case of individuals and 21 days in the case of companies from the date the amount was deducted or from the time the duty to deduct arose, whichever comes up earlier.

S. 85 of CITA provides a penalty of 10% per annum and interest at Central Bank rate for failure to remit withholding taxes due to FIRS. S. 74 of PITA provides for a fine of N5,000 or 10% of tax due, whichever is higher, in addition to the principal tax due and interest at the bank lending rate for failure to remit the withholding tax due to SBIR.

Table 10.1: Rates of Withholding Taxes in Nigeria

Type of Payments	Companies Rate (F.I.R.S.)	Individual Rate (S. B. I. R.)
Royalty	10%	5%
Rents (including hire of Equipment)	10%	10%
Dividends	10%	10%
Interests	10%	10%
Commissions	10%	5%
Consultancy & Professional Services	10%	5%
Technical Services	10%	5%
Management Services	10%	5%
Directors fees	-	10%
Building construction	5%	5%
Contract supplies	5%	5%

Comments:

(a) The deduction from companies are payable to the FIRS.

(b) The deduction from individuals are payable to the SBIR on the basis of residence.

(c) The deductions from individuals are payable to the FIRS, when they are made from residents of the FCT, Abuja, members of the Nigerian Armed Forces and Police, Officers of the Nigerian Foreign Service and persons resident outside Nigeria who derive income from Nigeria.

Withholding taxes on dividend, interest, rent and royalties when suffered by non-residents are final taxes. Also, with effect from January 1996, Withholding tax on interest and dividend are final taxes when suffered by Nigerians.

6.21.4 Credit Notes

As soon as payment is made to the bank or the Withholding Tax section of the tax office, credit notes must be issued in favour of the names (taxpayers) contained in the schedule. The credit notes are to be forwarded by the collection agent to the taxpayers who suffered the deductions immediately. This is because the credit notes are to be used in claiming tax credits at the various tax offices where their cases are handled. It is important to emphasis that the presentation of a letter from the collector agent showing that a taxpayer has suffered deductions is not enough for the FIRS to give credit. Similarly, Government treasury receipts issued by other Government Departments showing that they have deducted tax from a taxpayer is not enough to grant tax credit since only the FIRS can collect tax for the Federal Government, while only the SIRS can collect tax for the States.

6.21.5 Dual Roles of Collection Agents

Withholding Tax collection agents play a dual role since January 1994 when VAT was introduced:

(a) They act as agents in the deduction of Withholding Tax from contract sums payable to their contractors.

(b) They also act as agents in the collection of VAT from their contractors when such contractors are paid. This however, is where the VAT has been built into a contract. Where it was not, the awardee of the contract pays the VAT as the consumer of the contract service.

6.21.6 Advance Income Tax Payment

When a company wishes to pay dividend out of profit on which no tax has been paid, CITA Section 31(7) provides that tax at standard company tax rate is payable on the amount of the dividend. The provisions of Sections 15A and 16(B) of CITA is also to the same effect.

If any provisional tax has been paid by the company for the assessment year, this will be taken into account in determining the amount of tax payable under this Section.

The tax is payable before the dividend is paid and has nothing to do with withholding tax which will still be deducted normally.

The tax so paid will be taken as a deposit against the tax due from the company on the profits out of which the dividend is paid.

Thus, when the company wishes to settle its tax liability, the amount paid as deposit will be deducted from the total amount of the income tax liability of the company for that year.

ILLUSTRATION 6.7

A company is paying a dividend amounting to ₦500,000 in respect of the year ended 31 December, 2013 payable on 15 June, 2014. The tax adjusted profit of the company for the year was ₦800,000 after capital allowances. The company's audited accounts have been prepared and submitted to the Revenue but no assessment has been received up to the date of payment of the dividend.

Under this situation, the company will need to pay a tax of ₦150,000 (30% of ₦500,000) prior to the payment of the dividend.

Thereafter, the dividend of ₦500,000 can be paid subject to deduction of applicable withholding tax.

When the company is assessed to tax, its tax liability will be as follows:

	₦
Total profit	800,000
Income tax at 30% thereon	240,000
Less tax paid in advance	(150,000)
Balance of tax payable	**90,000**

Note:

Under the self assessment scheme, companies are not expected to wait to receive assessments from the Revenue before settling their respective tax liabilities.

6.22 CAPITAL ALLOWANCES

6.22.1 Introduction

The Second Schedule to CITA deals with companies Capital Allowances. The substance of this schedule is very similar to the provisions of the Fifth Schedule to PITA dealing with this topic as it relates to individuals. Thus, any knowledge of Capital Allowances in Personal taxation, can be conveniently and successfully applied to Companies taxation, the general rules of computation being the same.

6.22.2 Qualifying Expenditure

Qualifying expenditure means capital expenditure incurred in a basis period in connection with:

(a) Plant, machinery or fixtures;

(b) Buildings, structures or works of a permanent nature;

(c) Mines, oil wells or other sources of mineral deposits of a wasting nature;

(d) Plantations;

(e) Research and Development;

(f) Agricultural Plant;

(g) Public Transportation Motor Vehicles; and

(h) Public Transportation (inter-city) New Mass Transit Coach.

Any expenditure which is an allowable deduction in computing the profits of the company's trade or business in accordance with the provisions of Section 24 of CITA, shall not be treated as qualifying expenditure.

6.22.3 Assets Acquired on Hire-Purchase

When an asset is acquired under a hire-purchase agreement, the qualifying expenditure of such asset is the amount of installment paid by the hirer during its basis period, excluding any interest element in the installment. The interest element is an allowable deduction under Section 24 of CITA, in arriving at the profits of the company.

ILLUSTRATION 6.8

Hire-purchaser Nigeria Limited purchased Motor Lorries on hire purchase on 10 June, 1987 for use in its business. The initial deposit paid by the company amounted to ₦37.500m. The remaining purchase price being paid in twenty four monthly instalments of ₦4.6875m. The cash price of the lorry was ₦115m.

It is to be assumed that the company paid all the instalments when due and that its accounts are made up to the 31 December every year.

Required:

(a) State the taxation implications of this transaction for Hire purchaser Nigeria Limited.

(b) Compute the Capital Allowances for the relevant years of assessment.

SUGGESTED SOLUTION 6.8

The taxation implications of this transaction as far as Hire-purchaser Nigeria limited is concerned, are as follows:

(a) The interest element is an allowable deduction under Section 24 of CITA. Thus the total interest element will be spread in proportion to the amount paid in each accounting year and will be deductible in arriving at the profit of the company assessable to tax.

The interest element can be arrived at thus:

	₦'000
Amount of deposit	37,500
Total of instalments ₦4,687.50m x 24	112,500
Total hire purchase price	150,000
Less the cash price	115,000
Total interest element	35,000

The interest element can be apportioned to the relevant assessment years, using the sum of the digits method.

The sum of the digits for 24 instalments is (24 + 23 + 22 + 21 + 20 + 19 + 18 + 17 + 16 + 15 + 14 + 13 + 12 + 11 + 10 + 9 + 8 + 7 + 6 + 5 + 4 + 3 + 2 + 1) = 300

The interest apportionment will be arrived at thus:

Assessment year	Basis period that is Company's accounting		Amount of interest period ₦'000
1988	1/1/87 to 31/12/87	129/300 x N35,000	15,050
1989	1/1/88 to 31/12/88	150/300 x N35,000	17,500
1990	1/1/89 to 31/12/89	21/300 x N35,000	2,450
			35,000

The interest element deductible in arriving at the assessable profit of the company for each of the assessment years is as shown above. It should be noted that the interest element has been apportioned proportionately on time and amount basis as would any other finance cost. In a more simplified situation, the interest could be apportioned on the straight line method.

(b) The amount of the qualifying expenditure of the lorry is the cash price element of the total amount payable in each year of assessment. This can be arrived at as follows:

Assessment Year	Total amount payable in basis period ₦'000	Interest element as above ₦'000	Cash price element ₦'000
1988	65,625	15,050	50,575
1989	56,250	17,500	38,750
1990	28,125	2,450	25,675
	150,000	35,000	115,000

Initial allowance for the relevant assessment years will be granted on the amounts of the cash price elements as shown above. Annual allowances will similarly be granted on the cumulative of the qualifying amounts at the end of each of the basis period. The amounts of the allowances will be:

Initial allowance Rate - 25%, Annual Allowance rate - 20%.

	₦
1988	
Cash price payable for the year as above	50,575.00
Initial Allowance: 25% thereof	12,643.75
1989	
Cash price payable for the year as above	38,750.00
Initial Allowance: 25% thereof	9,687.50
	₦
1990	
Cash price payable for the year as above	25,675.00
Initial Allowance: 25% thereof	6,418.75
Annual allowance – Rate was 20%:	
1988 cash price element	50,575.00
Less initial allowance	12,643.75
	37,931.25
Annual allowance at 20% of 37,931.25	**7,586.25**
1989 Additional cash price	38,750.00
Less initial allowance thereon	9,687.50
	29,062.50
Annual allowance at 20% of 29,062.50	5,812.50
Add: annual allowance on 1988 expenditure	7,586.25
Total annual allowance for 1989	13,398.75
1990 Cash price element	25,675.00
Less initial allowance thereon	6,418.75
	19,256.25
Annual allowance at 20% of 19,256.25	3,851.25
Add: Annual allowance on 1988 expenditure	7,586.25
Annual allowance on 1989 expenditure	5,812.50
Total annual allowance for 1990	**17,250.00**

6.22.4 Points to Note Regarding Capital Allowances

The following points should be carefully noted with regard to capital allowances:

(a) Capital allowances will be granted only if these conditions are satisfied:

- (i) The company claiming must be the owner of the assets at the end of its basis period for a year of assessment; and
- (ii) The assets must be used for the purpose of a trade or business carried on by the company.

Note that the ownership and usage should be on the last day of the basis period of a year of assessment. For this purpose, a period of temporary disuse is ignored.

Also when an asset has been acquired but has not been put into use at the end of the basis period, capital allowances can be claimed provided the first use to which the asset will be put after that date is the purpose of the trade or business of the company. If eventually the asset is not put to such use, the Revenue Service can raise such additional assessment as might be necessary to counteract the benefit obtained from granting the capital allowances.

(b) The grant is for a year of assessment and is usually against the assessable profits of the basis period for that year of assessment. In the event of insufficiency of assessable profits to cover the claim due after the applicable restrictions, the unrelieved amount can be carried forward to future assessment years with no time limit.

(c) A claim should be made by the company before any capital allowance can be granted. However, if no claim is made, some allowances can still be granted where the Revenue is of the opinion that it would be reasonable and just to do so, for example, where Best of Judgment (BOJ) assessments are raised.

(d) Where the basis period for any year of assessment is a period less than one year, for example, when the commencement provisions are being applied, the annual allowance for that assessment year shall be proportionately reduced.

(e) The relief is granted by deduction from the remainder of assessable profits in the computation of the company's total profits. The remainder of the assessable profits is the assessable profits plus any balancing charge and less any loss relief due, that is capital allowance relief is granted after giving effect to loss relief.

(f) Unutilised allowances in the year of permanent cessation of a trade or business carried on by a company shall be available for relief against the remainder of its assessable profits for the preceding year of assessment and so on for other preceding years up to the fifth year before the year of permanent cessation.

(g) Where a relief is to be granted to a company after the assessment has become final and conclusive in respect of any assessment year, the Revenue Service may make such repayment or set-off of the tax, or any part of such tax, paid or charged for that year as may be appropriate, in lieu of making the deduction for the amount of the relief.

(h) The residue of expenditure is the total qualifying expenditure incurred less the total of any initial and annual allowances granted to date. Investment allowance should not be deducted from qualifying expenditure to arrive at the residue.

(i) In the year of permanent cessation of a trade or when an asset is disposed, balancing adjustment will need to be made. Balancing allowance will be granted when the proceeds of disposal or the value on the date of cessation is less than the residue of qualifying expenditure. A balancing charge, which will be limited to the capital allowances previously given, will be made if the value/ proceeds is greater than the residue.

(j) There is no difference in the meaning of "disposed of" and "value of an asset" as contained in CITA Second Schedule paragraphs 12 and 13 respectively, and that contained in PITA Fifth Schedule dealing with personal taxation.

(k) The amount of capital allowances calculated is generally restricted to a percentage (at present 66 $^{2}/_{3}$%) of the assessable profits. Any company in the agro-allied industry or that which is engaged in the trade or business of manufacturing is not affected by this restriction. A company in the agro-allied industry is any company carrying on agricultural trade or business, as defined.

Agricultural trade or business is defined in the Act as any trade or business connected with:

(i) The establishment or management of plantations for the production of rubber, oil palm, coffee, tea and similar crops;

(ii) The cultivation or production of cereal crops, tubers, fruits of all kinds, cotton, beans, groundnuts, sheanuts, beniseed, vegetables, pineapples, bananas and plantains;

(iii) Animal husbandry, that is to say, poultry, piggery, cattle rearing, fish farming, and deep sea fish-trawling";

(l) Any expenditure allowable under Section 20 as a trade expense and deductible in the computation of the company's profit from

its trade or business, cannot be treated as qualifying capital expenditure.

6.22.5 Basis Period

The basis period for capital allowances is normally the same as that used in the computation of assessable income. For example if accounts are made up to 30 September every year, the basis period for the purpose of determining assessable income for 2013 assessment year will be the accounting year ended 30 September, 2012 that is period 1 October, 2011 to 30 September, 2012.

Capital allowances would be claimed for the 2013 assessment year using the same basis period thus:

Initial allowance - on assets purchased during period 1/10/2011 to 30/9/2012

Annual allowance -on residue of expenditure at 30/9/2011 plus the annual allowance amounts calculated on the additions during the year to 30/9/2012. If there are disposals in the year, the residue of such will be eliminated from the residue at 30/9/2011 before the annual allowance is calculated.

This rule will usually be disrupted at commencement and cessation of a business as there will be overlapping and gaps of periods during these occasions.

The provisions in the Act are:

(a) where two bases periods overlap, the period common to both is treated except for the purpose of annual allowances, as falling to the first basis period only.

(b) where two bases periods coincide they shall be treated as overlapping and therefore rule (i) above will be applicable.

(c) Where there is an interval between the end of the basis period for one year of assessment and the basis period for the next year of assessment, the interval shall be treated as part of the second basis period unless the year of assessment based on the second basis period is the year of permanent cessation of the trade, when the interval is treated as part of the first basis period.

6.22.6 Buildings, Structures or Works of a Permanent Nature

The distinction between industrial and non-industrial buildings is the same as in PITA. The definition of industrial building as given in the Second Schedule, paragraph 5(b) of CITA is reproduced below:

"Industrial building or structure means any building or structure in regular use:

(a) As a mill, factory, mechanical workshop or other similar purpose, or as a structure used in connection with any such buildings;

(b) As a dock, port, wharf, pier, jetty or other similar building structure;

(c) For the operation of a railway for public use or of a water or electricity undertaking for the supply of water or electricity for public consumption; and

(d) for the running of a plantation or for the working of a mine or other source of mineral deposits of a wasting nature."

Any building not falling into any of these descriptions will automatically be a non-industrial building.

It should also be noted that the cost of land is not considered to be qualifying expenditure. Capital allowances therefore, cannot be claimed on the cost of land included in the cost of any building. Such cost should be deducted from the cost of the building in the computation of the applicable capital allowances.

Buildings purchased

When a building is purchased, the relevant interest to the company making the purchase is the original cost of construction of the building or the price paid for it, whichever is lower. If the building is purchased second-hand, no initial allowance can be claimed by the purchaser but annual allowance can be claimed based on the amount of the relevant interest as defined above. When a building is purchased new, initial and annual allowances are claimable by reference to the relevant interest, that is the cost of construction by the original owner or the purchase price, whichever is lower.

6.22.7 Mines, Oil Wells or Other Sources of Mineral Deposits of a Wasting Nature

This is covered among others in paragraphs 1 and 2, Second Schedule, CITA which contains similar provisions to PITA, Fifth Schedule, paragraph 2, but see comment under plantations below.

6.22.8 Plantations

Qualifying expenditure in connection with plantations is capital expenditure:

(a) On the clearing of land for planting

(b) On planting (other than replanting)

The (c) part of paragraph 1, Schedule 2, CITA deals with qualifying mining expenditure and is as follows:

(i) capital expenditure (hereinafter called "qualifying mining expenditure") incurred in connection with, or in preparation for, the working of a mine, oil well or other source of mineral deposits of a wasting nature (other than expenditure which is included in subparagraph (a) of this definition);"

(ii) capital expenditure (hereinafter called qualifying plantation expenditure") incurred in connection with a plantation:

- On the clearing of land for planting;
- On planting (other than replanting);
- On the construction of any works or buildings which are likely to be of little or no value when the source is no longer worked or, where the source is worked under a concession, which are likely to become valueless when the concession comes to an end to the company working the source immediately before the concession comes to an end;
- On the acquisition of, or of rights in or over, the deposits or on the purchase of information relating to the existence and extent of the deposits; and
- On searching for or on discovering and testing deposits, or winning access thereto".

A critical look at (d) above will reveal that subparagraphs (iii), (iv) and (v) thereof have no bearing to plantations. In fact, they relate to mining expenditure and should, therefore, have been included under paragraph (c). This is the treatment in PITA which in the absence of any evidence to the contrary, is also expected to be the same in CITA. Clearly, this is an error in the drafting of the Law. Consequently, subparagraphs (iii), (iv) and (v) in paragraph (d) above should be taken as relating to paragraph (c) and the qualifying expenditure on mining and plantations respectively.

6.22.9 Allowances

Initial allowance

This is granted in the first year of acquisition on the cost of purchase of the asset whether purchased new or second hand (but see the exception in respect of building as already discussed).

For example, an initial allowance of 25,000 will be claimed for a qualifying expenditure amounting to 50,000 on an asset which attracts an initial allowance rate of 50%.

The initial allowance to be granted would be such an amount as the Revenue Service may determine to be just and reasonable where either the seller has control over the purchaser or the purchaser has control over the seller of the asset. Such amount shall not exceed the amount of the initial allowance which would have been allowable except for this provision.

In respect of qualifying expenditure on plant and machinery for the replacement of old ones, one-off 95% capital allowance in the first year shall be allowed. The 5% book value shall be retained until the final disposal of the asset. Provided that the aggregate capital allowances granted in respect of any asset shall not exceed 95% of the total cost of the asset. (New Section 6(3) inserted in Decree 1996 No. 32 effective from 1 January, 1996).

Investment allowance (CITA Section 28)

In addition to an initial allowance, investment allowance can be claimed in respect of qualifying expenditure incurred on plant and machinery.

The rate is 10% of the expenditure.

The provisions of CITA relating to initial allowance also apply to investment allowance, except that an investment allowance is not to be deducted from cost of the assets in arriving at the residue of qualifying expenditure.

Investment allowance cannot be claimed, or if already granted, shall be withdrawn if any of the following happened within a period of five years from the date of acquisition of the assets:

(a) any sale or transfer of the asset otherwise than to a person acquiring the asset for a chargeable purpose or for scrap;

(b) any appropriation of the asset to a purpose other than a chargeable purpose;

(c) any sale or transfer or other dealing with the asset being a case where it appears either:

  (i) That the purpose of obtaining tax allowances was the sole or main purpose of the company for incurring the expenditure or for so dealing with the asset; or

  (ii) That the incurring of the expenditure and the asset being so dealt with, were not bona fide business transactions, or were artificial or fictitious transactions, and were designed for the purpose of obtaining tax allowances.

For the purpose of this Section "chargeable purpose" means the purpose of putting the assets to a use such that profits accrue or are intended to accrue therefrom and will be chargeable to tax.

Annual Allowance

This is granted annually and is computed on the balance of cost after the deduction of the amount of initial allowance claim on the asset. In the example of the item shown under initial allowance above, the annual allowance, assuming a rate of 25% shall be 6,250, that is, 25% of (50,000 – 25,000). Annual allowance once calculated for particular fixed asset item will be the same amount for each of the years that the asset is in use until the cost of the asset is fully relieved. A nominal sum of 10 per item is retained in the books in the last year of claim of annual allowance. It is retained until the item is disposed of.

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

ILLUSTRATION 6.9

New Business Nigeria Limited commenced a retail trade business on 1 October 2006 and makes up accounts to 30 September of every year. The following qualifying capital expenditure on plant and machinery were incurred:

Date	Amount
	₦
1/10/06	520,000
1/11/06	535,000
15/4/07	725,000

Required:

Compute capital allowances for the relevant years of assessment.

SUGGESTED SOLUTION 6.9
NEW BUSINESS NIGERIA LIMITED
COMPUTATION OF CAPITAL ALLOWANCES FOR THE RELEVANT YEARS OF ASSESSMENT

The annual allowance for the first year of assessment will be as follows:
First year of assessment is 2006 assessment year.
Basis period for capital allowance purposes is the period

1/10/06 to 31/12/06

	₦	₦
Total qualifying expenditure during that period		1,055,000
Less: Initial allowance at 50%		527,500
Balance of cost after initial allowance		527,500
Investment allowance is also due, since the item is plant and machinery:		
Investment allowance at 10% of 1,055,000	105,500	
Annual allowance:		
For a full year at 25% of 527,500	131,875	
But restricted to $^3/_{12}$ x 131,875, in view of number of months in the basis period being less than twelve.		32,969
Residue of expenditure carried forward-to the Second year of assessment		494,531

Whenever in doubt as to whether it is the initial or annual allowance that should be restricted when the basis period is shorter than twelve months, remember that – initial allowance is a one-off allowance and is therefore not to be restricted, while annual allowance is on an annual basis and is therefore to be proportionately restricted to the number of months in the basis period, if less than twelve months.

6.22.10 Capital Allowances Rates

The following are the current (2009) capital allowances rates:

		Initial allowance	Annual allowance
		%	%
Buildings (Industrial & non-Industrial)		15	10
Mining		95	Nil
Plant:	Agric Production	95	Nil
	Others	50	25
Furniture and Fittings		25	20
Motor Vehicles:	Public Transportation	95	Nil
	Others	50	25
Plantation Equipment		95	Nil

Housing Estate	50	25
Ranching and Plantation	30	50
Research & Development	95	Nil

These rates were effective from the 2006 assessment year.

The following should also be noted:

(a) In respect of qualifying expenditure on plant and machinery for the replacement of old ones, a one-off 95% capital allowance in the first year shall be allowed. The 5% book value shall be retained until the final disposal of the asset. Provided that the aggregate capital allowances granted in respect of any asset shall not exceed 95% of the total cost of the asset.

(b) A company engaged in gas utilisation (downstream operations) shall be granted accelerated capital allowances after the tax-free period of three years, as follows:

  (i) an annual allowance of 90 per cent with 10 per cent retention, for investment in plant and machinery,
  (ii) an additional investment allowance of 15 per cent which shall not reduce the value of the asset.

(c) Investment allowance of 10% on qualified plant and machinery expenditure is available from the 1993 assessment year.

6.22.11 Claim for Capital Allowances – Options

The following options are available with regard to Capital Allowance:

(a) Capital allowance must be claimed before it can be granted. This implies that normally it will not be granted when no claim is made by the company. Therefore a company that does not wish to be granted capital allowances in any particular assessment year can achieve that objective by not making a claim for such, in its tax computations.

(b) Where double taxation relief is applicable, paragraph 23 of Schedule 2, permits a company to elect that the initial or annual allowance due to it, be calculated at a lesser rate than that normally applicable as summarised under capital allowances rates above. When such election is made, the lesser rate desired by the company shall be the appropriate rate to be used to compute the amount of the capital allowances due to the company for that year of assessment.

6.23 DEFERRED TAXATION

The matching concept in accounting demands that sales and income are to be matched with the corresponding costs in preparing either a profit and loss account or an income and expenditure statement. If this is not done, there will be distortions in the profit or loss (excess or deficit of income compared to expenditure) declared for each accounting year. The result that would be obtained comparing one year with another in such situation would also be distorted.

The matching concept principle should also be extended to the charge for taxation in the profit and loss account. Usually, accounting profits as reported in the profit and loss account will be different from taxable profits. The charge for taxation shown in the financial statement may not bear a direct relationship with the amount of income or loss shown on the income statement. The differences are due to the fact that accounting profits would be adjusted to arrive at taxable profits. The adjustments are usually in respect of:

(a) Disallowable expenditure;

(b) Items chargeable to tax but not credited in the Profit and Loss account;

(c) Items credited in the Profit and Loss account but not taxable; and

(d) Expenditure not charged but allowable.

Some of these adjustments would cause certain income or profits to be brought into accounting profits in one period but brought into taxation in another period. Some other adjustments would completely eliminate an accounting profit or expense from tax without such being brought into tax in later accounting periods. These differences can be classified into two, namely: timing differences and permanent differences.

Those differences that would reverse in later accounting periods are called timing differences. Those that would not reverse in future accounting periods are referred to as permanent differences.

Permanent Differences

These are differences between taxable income and accounting income for a period that do not reverse in subsequent periods.

One reason for permanent differences is that certain items are considered to be properly included in one calculation but are required to be excluded from the other. For example, donations, other than those specified in Section 20 and Section 21 of CITA are not allowable deductions in determining taxable income. Similarly, certain items of income which are properly included in income statement are not subject to tax. For example, interest arising on certain Government Securities. Differences such as these are described as permanent differences.

Timing Differences

These are differences between the taxable income and accounting income which arise because the periods in which some items of revenue and expense are included in taxable income differ from the periods in which they are included in accounting income. Such differences originate in one period and reverse in one or subsequent periods.

A good example of timing difference is where the capital allowance rate used in determining taxable income differs significantly from the corresponding depreciation rate used in determining accounting profit. Also, expensing intangible development costs by taking hundred per cent deduction in the year the expenditure is incurred instead of the normal depreciation spread for accounting purpose, is another example. The incorporation in the balance sheet of the revaluation of fixed asset, could create a timing difference. This is because the profit or loss that would result if the asset is realised at its revalued carrying amount, would be taxable, unless the disposal of the revalued asset and of any subsequent replacement asset would not result in a tax liability, after taking account of any expected roll-over relief. Deferred Tax is the tax attributable to timing differences.

Bases of Providing for Deferred Tax

The objective of providing for Deferred Tax is to ensure that the tax expense reported in an income statement of a particular period reflects the tax effects of revenues and expenses included in the pre-tax accounting income of the period. Permanent differences are not taken into consideration as they have no effect on other periods.

Deferred Taxes can be treated on any of these three bases:

(a) Nil provision
(b) Full provision
(c) Partial provision

Nil provision

Tax effect of timing differences are ignored completely. Only the tax payable in respect of the accounting period is charged to income in that period and no provision is made for Deferred Tax. Proponents of this treatment hold the view that since tax liability arises only on taxable income and not on accounting income, there is no need to provide for Deferred Tax.

Full provision

Full provision basis takes into account all the timing differences. Support for this view is based on the principle that the tax effect of all the transactions occurring in each particular period has to be recognised in the financial statement of the period.

Partial provision

Under the partial provision basis, the tax effects of some timing differences are excluded from the computation of Deferred Tax when there is reasonable evidence that those timing differences will not reverse for some considerable number of years. Supporters of the view, argue that Deferred Tax has to be provided only where it is probable that tax will become payable as a result of the reversal of timing differences.

The partial provision basis has one major advantage over the other two bases discussed above. Under this method, the provision for Deferred Tax is based on an assessment of the ultimate tax liability.

Method of Computation

The tax effect of a timing difference (deferred tax) is usually computed as the difference between the tax computed after taking into account the transaction giving rise to the timing difference and the tax computed without including such transaction.
As tax rates change over time, giving rise to the question of what rate to use in computing deferred taxes, the choice of either the deferral or the liability method, becomes fundamental to the method of computation of Deferred Tax.

Deferral Method

Under the Deferral method, Deferred taxes are determined on the basis of the tax rates in effect, when the timing differences originate. No adjustments are made later, to take account of subsequent changes in tax rates. Reversals of the tax effects of timing differences are accounted for using the tax rates current at the time the timing differences arose. For practical purposes, the rate used may be either an average rate to date, or a rate determined through the first-in-first-out (FIFO) approach.

A basic argument against the deferral method is that the balance of Deferred Taxes may not represent the actual amount of additional taxes payable or receivable in the periods that the timing differences reverse.

Liability Method

Under the liability method, the amount of Deferred Tax is computed by using the tax rate expected to be in force during the period in which the timing differences reverse. Usually, the prevailing tax rate is used as the best estimate of future tax rates, unless changes in tax rates are known in advance.

Under this method, the Deferred Taxes provision represents the best estimate of the amount which would be payable or recoverable, if the relevant timing difference reverses. Thus, the difference between income tax expense and income tax payable for the period is directly adjusted on the deferred tax balance.

When accounting for timing differences results in a debit balance, prudence requires that such a debit can be carried forward in the balance sheet only if there is a reasonable expectation of realisation; that is, if sufficient future taxable income will be generated in the period in which the timing differences will reverse.

Tax Losses

Tax losses result in tax savings, provided that there is taxable income against which the losses could be relieved. Consequently, such potential tax savings relating to a tax loss carried forward, may be included in the income statement. Since the tax laws limit the period over which a tax loss may be carried forward as offset against future taxable income, only the related timing differences that will reverse during the limited period are considered in computing deferred taxes and treated either as a debit balance or as a debit to the Deferred Tax account.

Please note that tax savings that result from offsetting a tax loss is included in the net income.

Separate Line Method

It is the separate line method of presentation of deferred tax in financial statements that is encouraged in the Statement of Accounting Standard on Deferred Taxes (SAS No.19). The tax effects in the financial statements are shown separately from the items or transactions to which they relate. The main advantage of this method is that it distinguishes between an item and its tax consequences.

Other Accounting Standards Requirements

Deferred tax balance should be presented in the balance sheet separately from the shareholders interest. In case of a debit balance, it should be shown as an asset.

The disclosure required may be shown either on the face of the income statement or as notes to the financial statement. The total amounts of any deferred taxes, both current and cumulative, not provided for, should be disclosed by way of a note and analysed into components.

ILLUSTRATION 6.10

An industrial building of a Company that has been in business for several years purchased for 2 million during year ended 31/12/99 was revalued at ₦10 million as at 31/12/04, the balance sheet date of the company. The revalued amount is incorporated into the company's account as at 31/12/04. Calculate the capital gains tax and deferred tax liability.

Ignore roll-over relief.

SUGGESTED SOLUTION 6.10

For the purposes of calculating deferred tax, it will be assumed that the building will be disposed of at the revalued amount.

		₦
(a)	Balancing charge:	
	Disposal proceeds	10,000,000
	Less Tax written down value on the date of disposal(see workings below)	680,000
	Surplus of proceeds over residue of expenditure	9,320,000
	Balancing charge will be restricted to capital allowances previously granted (2,000,000 – 680,000)	1,320,000
	Income tax effect of the balancing charge @ 30% (that is deferred tax liability)	396,000
(b)	**Capital gains tax**	
	Disposal proceeds were the building to be disposed of at the revalued amount at 31/12/04	10,000,000
	Less acquisition cost	2,000,000
	Capital gains	8,000,000
	Capital gains tax at 10% thereof	800,000
	Residue of Expenditure – 31/12/2004	

	₦
2000 Assessment Year	
Cost Year Ended 31/12/99	2,000,000
Initial allowance 15%	300,000
Balance after initial allowance	1,700,000
Annual allowance 10%	170,000
2000 Residue c/f	1,530,000
2001 Assessment Year	
Annual allowance	170,000
2001 Residue c/f	1,360,000
2002 Assessment Year	
Annual allowance	170,000
2002 Residue c/f	1,190,000
2003 Assessment Year	
Annual allowance	170,000
2003 Residue c/f	1,020,000
2004 Assessment Year	
Annual allowance	170,000
2004 Residue c/f	850,000

2005 Assessment Year	
Annual allowance	170,000
2005 Residue c/f	680,000

NOTE:
Though, annual allowance is not usually granted on any fixed asset item in the year of disposal, it should be recognised that this item was indeed not disposed of at the balance sheet date and therefore annual allowance thereon would have been claimed in the year 2005 tax computation. This is why it is the residue of expenditure after the 2005 annual allowance claim that is used in arriving at the balancing charge.

ILLUSTRATION 6.11
The depreciation charge for the year in respect of a company's fixed assets was the sum of ₦500,000. The corresponding capital allowances computation produced a figure of ₦750,000. State the deferred tax effect.

SUGGESTED SOLUTION 6.11

	₦
Capital allowances	750,000
Less: Depreciation charged in the accounts	500,000
Timing difference	**250,000**

A provision for deferred tax of ₦75,000 (₦250,000 x 30%) is required in the current year's accounts.

The fact that the Capital allowances figure above is greater than the depreciation figure implies that the tax charged in the year would be less than it should have been were the Capital Allowances and depreciation figures to be the same. Therefore, more tax would be due in later years when the timing difference would reverse.

6.24 CHAPTER REVIEW

This chapter provides information about profits and sources of profits of corporate bodies that are subject to tax under the Companies Income Tax Act, CAP C21 LFN 2004.

Profits or gains of corporate bodies are taxed, while losses are allowed to be relieved against profits of subsequent years. Losses can be carried forward generally for a total of four years but there is no time limit for relief of losses incurred by companies engaged in agricultural business.

The bodies and associations whose income or profits are exempted from tax under the Act were listed. Some incomes are exempted on the condition that they were not derived from trade or business being carried on. Others are

exempted even if they were derived from trade or business. Readers must have learnt the principle of allowable and disallowable deductions as applicable to companies chargeable to tax under CITA.

An allowable expenditure has to be that expenditure that is wholly, exclusively, necessarily, and reasonably incurred by the company in the production of the income.

It has also been shown how the basis period of assessment is to be determined for tax purposes.

It has been demonstrated that the preceding year basis rule is applicable generally in the taxation of companies except at commencement or cessation of business.

The global profits of Nigerian companies are taxable irrespective of whether or not they are brought into or received in Nigeria. On the other hand, the profits of non-Nigerian companies are chargeable under CITA to the extent that they are derived from such companies' operations in Nigeria subject to applicable exemptions in any available double taxation agreements. Companies profits chargeable to tax under CITA are assessed to Income tax at 30% of total profits and Education Tax @ 2% of Assessable Income.

A small business rate of 20% is applicable to companies with turnover of ₦1,000,000 (one million Naira only) and below in each year of assessment for five years from the date of commencement of the business.

The lower rate applies to companies that are engaged in the business of manufacturing; agricultural production; mining of solid minerals or wholly export trade.

6.25 WORKED EXAMPLES

6.25.1 Questions

1. Ugo Limited has been in trading business for many years making up accounts to 31 December each year.
   The following Assessable profit/(Loss) have been agreed.

	₦
Year to 31/12/93	1,200,000
Year to 31/12/94	(840,000)
Year to 31/12/95	1,420,000
Year to 31/12/96	984,000

The company acquired the following assets:

Year End	Assets	Quantity	
			₦
31/12/93	Furniture & Fittings	10	180,000
	Vehicles	**5**	**400,000**
31/12/94	Plants	20	800,000
31/12/95	Furniture & Fittings	8	160,000
	Vehicles	2	640,000
31/12/96	Equipment	10	220,000
	Plants	1	180,000

Required:

Compute the Total Income of Ugo Limited for all the relevant years of assessment.

2. Quick Business is a trading company dealing with the importation and distribution of milk. It commenced business on 1 July 2003. Accounts are made up to 30 September every year. The following fixed assets were acquired by the company:

Date	*Item*	₦
30/4/03	Motor Vehicle for Public Transportation by majority shareholder	1,500,000
5/6/03	Building	1,500,000
1/7/03	Distribution vans	2,500,000
5/7/03	Office Equipment	500,000
31/7/03	Office Equipment	1,000,000
1/10/03	Motor Vehicle No. 1	750,000
31/12/03	Office Equipment	250,000
15/1/04	Computer Equipment	2,000,000
30/6/04	Motor Vehicle No. 2	1,250,000
31/10/04	Building extension	2,200,000

Required:

Compute the capital allowances for all relevant years on the basis that no election is made to have the 2nd and 3rd years of assessment based on the actual results for those years.

3. Manufacturing Company Plc has been in business for several years. Financial statements are made up to 30 June every year. The following acquisitions and disposals of fixed assets were effected in the year ended 30 June 2004.

	₦
Industrial Buildings	5,000,000
Plant and Machinery	1,750,000
Motor Vehicles	3,500,000

The following disposals were made during the same period:

Motor Vehicle – acquired for ₦1,500,000 in year ended 30/6/2002 sold for ₦2million

The residues of qualifying expenditure as at 1 July 2003 are:

	₦
Industrial Building (5yrs more)	10,000,000
Plant and Machinery (2yrs more)	2,000,000
Motor Vehicles (2yrs more)	3,000,000

Required:
Show the relevant capital allowances computation

4. TORONTO Limited was incorporated in January 2006 and results of the company for the first 3 years of the commencement of business are as follows:

	₦
Period to 30/09/2006	2,047,807
12 months to 30/09/2007	15,804,258
12 months to 30/09/2008	44,265,223

The company acquired assets as follows:

Date of Acquisition	Description	Amount
		₦
1/2/2006	Industrial Building	6,000,360
1/4/2006	Plant A	2,495,000
4/7/2007	Furniture & Equipment	1,200,000
7/7/2008	Plant B	5,000,000

The industrial building was sold on 4 August 2007 for ₦9,000,000. A new industrial building was purchased on 1 December 2007 for ₦10,250,000. The

company made a claim for Roll Over relief and this was approved by the tax authority.

Required:

(a) Compute Assessable Income for relevant years of Assessment together with Capital allowance assuming the taxpayer did not exercise the right of election under Section 25(3)(d) of the Act.

(b) Explain the principle to be followed should Toronto had exercise its right of election at commencement of business.

NB:

Rates of Capital Allowances are given as follows:

Assets	Initial	Annual
Industrial Building	15%	10%
Plant	50%	25%
Furniture & Equipment	25%	20%

6.25.2 Suggested Solutions

1. UGO LIMITED
CALCULATION OF TOTAL PROFITS

1994 Year of Assessment

		₦	₦
Assessable profit			1,200,000
Less: Capital Allowances –Initial			(127,000)
	Annual		(75,300)
Total Profit			997,700

1995 Year of Assessment

Assessable Profit/(Loss) c/f			(840,000)
Capital Allowance	Investment	80,000	
	Initial	160,000	
	Annual	139,300	
Unrelieved Capital allowance c/f			(379,300)
Total Profit			NIL

1996 Year of Assessment

Assessable Profit		1,420,000
Less: Loss Relief – Loss b/f		(840,000)
		580,000
Capital Allowances b/f	379,300	

	Initial	360,000	
	Annual	426,800	
		1,166,100	
Maximum is 66 2/3% of ₦1,420,000 (₦946,667)			
C.A. that can be relieved		(580,000)	(580,000)
Unrelieved Capital allowace c/f		586,100	
Total Profit			**NIL**

1997 Year of Assessment

Assessable Profit			984,000
Less:			
Capital Allowances	b/f	586,100	
	Investment	40,000	
	Initial	200,000	
	Annual	476,750	
		1,302,850	
Restricted to 66 2/3% of ₦984,000			
Capital allowance that can be relieved		(656,000)	(656,000)
Unrelieved C.A. c/f		646,850	
Total Profit			**328,000**

CAPITAL ALLOWANCES COMPUTATION

	Furniture & Fittings	Vehicles	Plant & Equipment	Total
1993 to 1995 Rates:				
Initial Allowance	15%	25%	20%	
Annual Allowance	10%	20%	10%	
Investment allowance			10%	
	₦	₦	₦	₦
1994 YOA				
Cost	180,000	400,000	-	580,000
Initial Allowance	(27,000)	(100,000)	-	(127,000)
Annual Allowance	(15,300)	(60,000)	-	(75,300)
WDV c/d	**137,700**	**240,000**	**-**	**377,700**
1995 YOA				
WDV b/f	137,700	240,000	-	377,700
Addition	-	-	800,000	800,000
Investment allowance			80,000	80,000
Initial Allowance	-	-	(160,000)	(160,000)
Annual Allowance	(15,300)	(60,000)	(64,000)	(139,300)
WDV c/f	**122,400**	**180,000**	**576,000**	**878,400**

Rates from 1996

Initial Allowance	25%	50%	50%	
Annual Allowance	20%	25%	25%	
	₦	₦	₦	₦
1996 YOA				
WDV b/f	122,400	180,000	576,000	878,400
Additions	160,000	640,000	-	800,000
Initial Allowance	(40,000)	(320,000)	-	(360,000)
A.A. on 1994 acq.	(40,800)	(90,000)	-	(130,800)
A.A. on 1995 acq.	-	-	(192,000)	(192,000)
A.A. on 1996 acq.	(24,000)	(80,000)	-	(104,000)
WDV c/f	**177,600**	**330,000**	**384,000**	**891,600**

Summary of annual allowances:

On 1994 acquisitions	130,800
On 1995 acquisitions	192,000
On 1996 acquisitions	104,000
	426,800

1997 YOA

WDV b/f		177,600	330,000	384,000
891,600				
Additions	-	-	400,000	400,000
Investment allowance			40,000	40,000
Initial Allowance	-	-	(200,000)	(200,000)
A.A. on 1994 acq.	(40,800)	(89,950)	-	(130,750)
A.A. on 1995 acq.	-	-	(192,000)	(192,000)
A.A. on 1996 acq.	(24,000)	(80,000)	-	(104,000)
A.A. on 1997 acq.	-	-	(50,000)	(50,000)
WDV c/f	**112,800**	**160,050**	**342,000**	**614,850**

Summary of annual allowances:

	₦
On 1994 acquisitions	130,750
On 1995 acquisitions	192,000
On 1996 acquisitions	104,000
On 1997 acquisitions	50,000
	476,750

Upon the change of Capital allowance rates in 1996, the annual allowances of the old qualifying expenditure will be recomputed on the basis of the new annual allowances rates:

	F & F	Vehicles	Equipment
Residue end of 1995 YOA	122,400	180,000	576,000
No. of years left with new rates	3	2	3
Annual Allowance from 1996	40,800	90,000	192,000

Notes

(a) From 1993 Assessment year, investment allowance of 10% is available on qualifying plant and machinery expenditure.

(b) Investment allowance is not to be deducted in arriving at the WDV of the asset.

2. **QUICK BUSINESS LIMITED**
CAPITAL ALLOWANCE COMPUTATIONS

The company commenced business on 1 July 2003.

Accounts would be made up as follows

1/7/2003 to 30/9/2003	3 months
1/10/2003 to 30/9/2004	12 months
1/10/2004 to 30/9/2005	12 months

Basis Period: No election for the 2 and 3 assessment years to be based on actual.

2003 Assessment Year	1 Year Actual	1/7/2003 to 31/12/2003
2004 Assessment Year	2 Year 1 12 months	1/7/03 to 30/6/04
2005 Assessment Year	3 Year P/Y basis	1/10/2003 to 30/9/2004
2006 Assessment Year	4 Year P/Y	1/10/04 to 39/9/05

QUICK BUSINESS LIMITED

CAPITAL ALLOWANCE COMPUTATIONS

	Basis Period for Capital Allowances Purposes:	
Assessment Year	Assessment Basis Period	Capital allowances Basis Period
2003	1/7/2003 to 31/12/2003	1/7/2003 to 31/12/2003
2004	1/7/2003 to 30/6/2004	1/1/2004 to 30/6/2004
2005	1/10/2003 to 30/9/2004	1/7/2004 to 30/9/2004
2006	1/10/2004 to 30/9/2005	1/10/2004 to 30/9/2005

	Non-Industrial Building	Plant & Machinery	Motor Vehicles	Total Allowances
Allowances Rates:				
Initial	15%	50%	50%	
Annual	10%	25%	25%	
Investment	-	10%	-	
	₦'000	₦'000	₦'000	₦'000
2003 Assessment Year				
Acquisitions				
5/6/03	1,500	-		
1/7/03			2,500	
5/7/03		500		
31/7/03	1,000			
1/10/03			750	
31/12/03		250		
Total acquisitions (A)	**1,500**	**1,750**	**3,250**	
Inv. Allowance	-	175	-	175
Initial Allowance (B)	225	875	1,625	2,725
Balance after IA (A-B)=C	**1,275**	**875**	**1,625**	
A.A. Full Year	128	219	406	
6 months in Basis Period				
AA claim = ½ (D)	64	110	203	377
Residue c/f (C – D)	1,211	765	1,422	
2004 Assessment Year				
Residue b/f (A)	1,211	765	1,422	
Additions				
15/1/04	-	2,000	-	
30/6/04	-	-	1,250	
Total additions	**-**	**2,000**	**1,250**	
Investment All.	200	200	-	200
Initial Allowance	-	1,000	625	1,625
Bal. after I.A. (B)	**-**	**1,000**	**625**	
A.A. on 2004 additions	-	250	156	
AA on 2003 additions	128	219	406	
Total AA Claim (C)	128	469	562	1,159
Residue c/f (A + B – C)	1,083	1,296	1,485	

2005 Assessment Year				
Residue b/f (A)	1,083	1,296	1,485	
Additions	-	-	-	
AA on 2004 additions	-	250	156	
AA on 2003 additions	128	219	406	
Total AA Claim (B)	128	469	562	1,159
Residue c/f (A – B)	955	827	923	
2006 Assessment Year				
Residue b/f (A)	955	827	923	
Additions	2,200	-	-	
Initial allowance	330	-	-	
Bal. after IA (B)	1,870	-	-	
AA on 2006 addition	187	-	-	
AA on 2004 addition	-	250	156	
AA on 2003 addition	128	219	406	
Total AA claim (C)	315	469	562	1,346
Residue c/f (A + B – C)	2,510	358	361	

Notes:

(a) All acquisitions before the date of commencement are deemed to have been acquired on the first date of commencement of the company's business.

(b) The item purchased on 30/4/2003 was not for the purpose of the trade of distribution of milk. Capital allowance cannot be granted for such.

3. **MANUFACTURING COMPANY PLC**
2005 CAPITAL ALLOWANCES COMPUTATION

	Industrial Building ₦'000	Plant and Machinery ₦'000	Motor Vehicles ₦'000	Total Allow ₦'000
Residue b/f	10,000	2,000	3,000	
Disposal at WDV	-	-	375	
Net Residue (A)	10,000	2,000	2,625	
Additions:	5,000	1,750	3,500	
Investment Allow.		175		175
Initial Allow.	750	875	1,750	3,375
Balance after Initial Allow (B)	4,250	875	1,750	

	₦	₦	₦	N
AA on 2005 additions	425	219	438	
AA on residue	2,000	1,000	1,313	
Total annual allowances (C)	2,425	1,219	1,751	5,395
Residue c/f (A + B – C)	**11,825**	**1,656**	**2,624**	

WDV of disposal
2003 Assessment year
Motor Vehicle Cost

Year end 30/6/2002	1,500,000
Less Initial Allowance	750,000
Balance after Initial Allowance	750,000
Annual Allowance	187,500
2003 Residue C/f	562,500

2004 assessment year

Annual Allowance	187,500
Tax written down value of disposal	375,000

Note that disposal was in 2005 assessment year. Vehicle was not in use on the last day of the basis period for the assessment year. Thus annual allowance cannot be claimed for the vehicle in 2005 assessment year.

	₦
Summary of Capital Allowances	
Investment allowance	175,000
Initial allowance	3,375,000
Annual allowance	5,395,000
Balancing charge	1,125,000
Balancing Charge on Vehicle Disposed	
Sales Proceeds	2,000,000
Less Tax written down value at time of disposal	375,000
Surplus	1,625,000
Balancing charge has to be	
Restricted to Capital allowance previously granted:	
Cost	1,500,000
WDV	375,000
Therefore, Capital allowance previously granted	1,125,000
Balancing Charge	**1,125,000**

4. TORONTO LIMITED
COMPUTATION OF ASSESSABLE INCOME
2008 YEAR OF ASSESSMENT

Assessment Year	Basis Period	Amount	
		₦	
2006	1/4/06 - 31/12/06; 1/4/06 - 30/9/06	2,047,807	
	1/10/06 - 31/12/06	3,951,065	5,998,872
	($^3/_{12}$ x 15,804,258)		
	Deduct:		
	Capital Allowances		2,763,983
	Assessable Income		**3,234,889**
2007	1/4/06 - 31/12/07; 1/4/06 - 30/9/06	2,047,807	
	1/10/06 - 31/3/07	7,902,129	9,949,936
	($^6/_{12}$ x 15,804,258)		
	Deduct:		
	Capital Allowances		821,906
	Assessable Income		**9,128,030**
2008	1/10/06 - 30/9/07		15,804,258
	Deduct:		
	Capital Allowances		1,085,625
	Assessable Income		**14,718,633**
2009	1/10/07 - 30/9/08		44,265,223
	Add: Balancing Charge		1,792,554
			46,057,777
	Deduct:		
	Capital Allowances		3,723,125
	Assessable Income		**42,334,652**

NOTE:
The Company can elect, by giving notice to the Board, within 2 years after the end of 2008 to reverse the assessment for 2007 and 2008, unto actual basis, if that will minimise its tax liabilities.

Workings

i COMPUTATION OF CAPITAL ALLOWANCES

	Industrial Building	Plants	Furniture	Total Allowances
Rates:				
I. A.	15%	50%	25%	
A. A.	10%	25%	20%	
Assessment Year 2006				
Acquisitions				
1/2/2006	6,000,360	-	-	
1/4/2006	-	2,495,000	-	
	6,000,360	2,495,000	-	
Allowances				
I.A	(900,054)	(1,247,500)	-	2,147,554
A.A (9 months)Wii	(382,523)	(233,906)	-	616,429
TWDV c/f	4,717,783	1,013,594	-	**2,763,983**
Assessment year 2007				
A.A	(510,031)	(311,875)	-	821,906
TWDV c/f	4,207,752	701,719		
Assessment year 2008				
Acquisition				
4/7/07	10,250,000		1,200,000	
1/12/07	9,000,000	1,250,000	- -	
	5,457,752	701,719	1,200,000	
Less:				
TWDV on Disposal	(4,207,752)	-	-	
	1,250,000	701,719	1,200,000	
Allowances				
I. A.	(187,500)	-	(300,000)	487,500
A.A.	(106,250)	(311,875)	(180,000)	598,125
TWDV c/f	956,250	389,844	720,000	**1,085,625**
Assessment year 2009				
Acquisition				
7/7/08	-	5,000,000	-	
	956,250	5,389,844	720,000	
Allowa nces				
I. A.	-	(2,500,000)	-	2,500,000
A.A. (W ii)	(106,250)	(936,875)	(180,000)	1,223,125
TWDV c/f	850,000	1,952,969	540,000	**3,723,125**

COMPUTATION OF ANNUAL ALLOWANCES

ASSESSMENT YEAR 2006

(a) Industrial Building

10% of (6,000,360 - 900,0545) x $^9/_{12}$

= 510,031 x $^9/_{12}$	=	382,523

(b) Plant

25% of (2,495,000 - 1,247,500) x $^9/_{12}$

= 311,875 x $^9/_{12}$	=	233,906

Assessment Year 2009

Annual allowance on Plant A (Wi)	311,875
Annual allowance on Plant B	
25% of (5,000,000 - 2,500,000	625,000
	936,875

COMPUTATION OF BALANCING ADJUSTMENT

Sales Proceeds	9,000,000
Less TWDV (Wi)	(4,207,752)
Balancing charge	4,790,248

Restriction

Balancing charge is restricted to

Total Capital Allowance claimed to date = ₦1,792,608

TORONTO LTD'S OPTION OF ELECTION FOR THE SECOND AND THIRD YEAR OF ASSESSMENT

To determine whether or not Toronto Ltd should exercise its option to elect under Section 25(3)(d). Do the following:

(a) Compute the assessment on actual basis (i.e actual profit from 1 January to 31 December of each assessment year for 2007 and 2008 Year of assessment and obtain the total for the two years;

(b) Compare the total assessable profits so computed in (i) above with the total assessed for those two years (2007 and 2008) assuming there was no election;

(c) Election is advantageous to the taxpayer if the actual basis produces lesser total assessable profit than normal basis. In computing assessable profits for the first three years of a new trade or business, taxpayer's right of election is not automatically effected unless the company expressly applied for it in accordance with the provisions of the Act.

(d) Election has to be made in writing within two years after the second year of Assessment;

(e) Revocation of election must be within 12 months of the 3rd year.

CHAPTER 7

Persons Chargeable, Offences and Penalties

Contents

1. Purpose
2. Introduction
3. Chargeability to Tax
4. Persons Answerable
5. Directors Appointment of Agent (Section 38)
6. Company in Liquidation (Section 40)
7. Company's Representative on Tax Matters
8. Offences and Penalties
9. Other Offences and Penalties (Part XII of CITA)
10. Chapter Review
11. Worked Examples

7

PERSONS CHARGEABLE, OFFENCES AND PENALTIES

7.0 PURPOSE

After studying this chapter, readers should be able to:

(a) understand the provisions of the Companies Income Tax Act CAP C21 LFN 2004 (as amended)

(b) know the persons chargeable to tax and the persons answerable to the tax office in respect of the tax chargeable under CIT.

(c) know who may be appointed as agent of the Revenue for CITA purpose

(d) know the various offences and related penalties under the provisions of CITA.

7.1 INTRODUCTION

Since a company is a separate entity different from its shareholders, it is important that there should be a clear conception of how a company can be charged to tax and who should be answerable for the organisation in that regard. Part VII (Sections 36 to 40) of the CITA contains the relevant provisions.

7.2 CHARGEABILITY TO TAX

Section 36 of CITA 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 the company in Nigeria, in like manner and to like amount, as such company would have been chargeable; or

(c) 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 had been appointed."

(a) and (b) above relate to a going concern company while (c) is in respect of any company in receivership or in liquidation.

7.3 PERSONS ANSWERABLE

Section 37 states: "The principal officer or manager in Nigeria of every company shall be answerable for doing all such acts, matters and things as are required to be done by virtue of the Act for the assessment of the company and payment of the tax." Though there is no reference to this in Section 37, for a company in receivership or in liquidation "the principal officer or manager" is the receiver or liquidator, as appropriate.

7.4 DIRECTORS APPOINTMENT OF AGENT (SECTION 38)

The Revenue Service or Directors of a company may appoint any person to be the agent of any company. Any person so declared may be required to pay any tax, which is or will be payable by the company, from any of the company's money, that is, or will be, in the possession of the agent. If the person declared as the agent fails to comply with such request, the tax shall be recoverable directly from the company.

Such a person, however, has a right of objection and appeal for any notice served upon him in accordance with the provisions of Section 38, as if such notice were an assessment on him personally.
Section 39 empowers the agents, or any other person answerable for the payment of tax on behalf of a company, to deduct from any of such company's money coming into his hands so much thereof as shall be sufficient to pay the tax.

7.5 COMPANY IN LIQUIDATION (SECTION 40)

Before any distribution can be made to the shareholders of a company in liquidation, the liquidator must ensure that he has made provision for the payment in full of any tax which may be ascertained payable by the company, including any tax deductions made by the company under any law in force in any part of Nigeria relating to the taxation of individuals.

7.6 COMPANY'S REPRESENTATIVE ON TAX MATTERS

Every company shall designate a representative who shall answer every query relating to the company's tax matters. Such a person should be knowledgeable in the field of taxation as may be approved from time to time by the Revenue Service (Section 41(6).

7.7 OFFENCES AND PENALTIES

Part XII of CITA contains provisions relating to offences and penalties. The following is a list of what constitute offences under the Act, together with the prescribed penalties on conviction.

	Offences	Penalties
(a)	Contravention or failure to comply with any of the provisions of the Act or any rule made thereunder: Section 71(1)	A fine of ₦20,000 and where the offence is the failure to furnish a record required, a further sum of ₦20,000 for each and everyday during which such failure continues. In default of payment then to imprisonment for six months. This penalty is also applicable for an offence or contravention of any of the provisions of the Act for which no other penalty is specifically provided.statement or information or to keep.
(b)	Failure to comply with the requirements of a notice served on any person under the provisions of the Act: Section 71(2)(a)	As for (a) above.
(c)	Failure, without sufficient cause, to attend or answer to a notice or summons served on any person under the provisions of the Act, or having attended, failure to answer any question lawfully put to him: Section 71(2)(b)	As for (a) above.
(d)	Making of incorrect returns, without reasonable excuse, by omitting or understating any profits liable to tax under the Act:	A fine of ₦200,000 and double the amount of tax which has been undercharged in consequence of such incorrect return or information, Section72(1)(a) or would have been so undercharged if the return or information has been accepted as correct.
(e)	Giving of incorrect information, without reasonable excuse, in relation to any matter or thing affecting the liability of any company to tax: Section 72(1)(b).	As for (d) above.

	Offences	Penalties
(f)	Knowingly making false statement or false representation for the purpose of obtaining any deduction, set-off, relief or repayment in respect of any company: Section 73(1)(a).	A fine of ₦200,000 or to an imprisonment for three years or to both such fine and imprisonment.
(g)	Aiding, abetting, assisting, counselling, inciting or inducing any other person-(i) to make or deliver any false return or statement under the Act; or (ii) to keep or prepare false accounts or particulars concerning any profits on which tax is payable under the Act; or (iii) unlawfully to refuse or neglect to pay tax: Section 73(1)(b)	As for (f) above.
(h)	(a) Any official of the Revenue Service or any of its employees shall also be guilty of an offence: (i) demanding from any company an amount in excess of the authorised assessment of the tax; or ii) withholding for his own use or otherwise any portion of the amount of tax collected; or (iii) rendering a false return, orally or in writing, of the amount of tax collected or received by him; or (iv) (a) defrauding any person, embezzling any money or otherwise using his position as to deal wrongfully with the Revenue Service; or (b) Collecting or attempting to collect the tax under the Act without being authorised under the Act to do so: Section 74	A fine equivalent to 200 percent of the sum in question or to imprisonment for three years or to by: both such fine and imprisonment.
(i)	Late filing of Income Tax Returns Section 55(3)(5) and 85(1) of CITA	Failure to file on or before six months after the companies end of accounting year attracts ₦25,000 for the first month which the failure occurs and ₦5,000 for each subsequent month. Upon conviction, the responsible officer of the company may be liable to a fine of ₦100,000 or 2 years imprisonment or both.

	Offences	Penalties
(j)	Late payment or non-payment of tax Section 55(3)(5) and 85(1) of CITA.	Penalty is 10% of amount of tax payable and interest at the Monetary Policy Rate (MPR) plus a spread to be announced by the Finance Minister.
(k)	Failure to pay Tertiary Education Tax after 60 days of the service of notice of assessment. {Tertiary Education Tax Fund - (Establishment etc) Act 2011] – S10(2)(3), 11(1).	- 5% of the tax in addition to the principal tax, for failure to pay after two month. If failure to pay still continues after two months, the following additional penalties apply:- (a) First Offenders – ₦10,000 or imprisonment for a term of 3 years. (b) Second or Subsequent offenders – ₦20,000 or imprisonment for a term of 5 years or both.
(l)	Information Technology (IT) Tax Assessed but not payable within 60 days of service of notice of Assessment. Section S16(4) of NITDA 2007.	Penalty is 2% of tax payable.
(m)	Failure to remit WHT due to FIRS (Section 85 of CITA)	Penalty is 10% per annum and interest at Central Bank Rate(MPR).

The imposition of a penalty, fine or imprisonment under any of the situations above shall not relieve any company from liability to payment of any tax for which it is or may become liable (Section 75).

The provisions of CITA with regards to the offences and penalties also do not affect any criminal proceedings under any other enactment (Section 77). Offences under CITA shall be deemed to occur in the town where the registered office of the company is situated or at such other place, as the Revenue Service may decide (Section 78).

7.9 OTHER OFFENCES AND PENALTIES

The offences and penalties listed in Part XII of the Act which have been summarised above, are additional to those that are contained in other Sections of the Act.

7.9.1 Duty of Secrecy and confidentiality

Section 5(1) requires every person having any official duty or being employed in the administration of the Act to regard and deal with all documents, information, returns, assessment lists and copies of such lists relating to the profits or items of the profits of any company, as secret and confidential.

Any wrongful communication or attempt to communicate the information contained in these documents to unauthorised person(s) is an offence under Section 5(2) of the Act. Since Section 5(2) does not contain any reference to penalty, in accordance with Section 71(1) this penalties applicable on conviction shall be a fine of 20,000. (see penalty (a) above).

7.9.2 Obstruction of officials in their duties

Section 7(5) makes it an offence for any person to obstruct any officer of the Revenue Service in the exercise of his (the officer's) function under the Act or to use violence on such officer.

The penalties applicable on conviction as provided by this subsection are –

(a) in the case of a first offence, imprisonment for not exceeding three years or a fine of not less than ₦200,000 or both.

(b) in the case of a second or subsequent offence and in any case where violence is used on any such officer, imprisonment for six months without the option of a fine.

7.9.3 Investment allowance improperly claimed

Section 28(6) provides that, where any asset on which an investment allowance has been granted is sold, transferred or appropriated to another person or purpose other than a chargeable purpose within a period of five years from the date of purchase of the assets, the company is to give notice of such event to the Revenue Service.

Section 28(7) requires that, such notice to the Revenue Service should state the name and address of the person to whom the sale or transfer is made.

Section 28(8) empowers the Revenue Service to obtain information from any person about any sale or transfer of any asset on which the investment allowance has been granted or about any other dealing with the asset. Section 28(9) provides for a penalty of ₦100,000 on conviction, plus the amount of tax lost by granting of the investment allowances, for failure to comply with any of the foregoing provisions.

7.9.4 Failure to render a return

Subsections (1), (2) and (3) of Section 41, require every company to make and deliver to the Revenue Service a return together with its audited accounts and other schedules required in the computation of the taxable profits of the company. These documents are to be filed with the Revenue Service not later than six months after the close of the company's accounting year or in the case of a newly incorporated company, within eighteen months from the date of incorporation or not later than six months after the end of its first accounting period, whichever is earlier.

Subsections (4) and (5) of the same Section provide for the penalties for the contravention of the provisions in subsections (1), (2) and (3). Subsection (4) provides for a fine of:

₦25,000 in the first month in which the failure occurs; and ₦5,000 for each subsequent month in which the failure continues.

Where the offence can be proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, any director, manager, secretary or other similar officer, servant or agent of the company (or any person purporting to act in any such capacity), Subsection (5) provides that such person as well as the company shall be deemed to be guilty of the offence and shall, on conviction, be liable to a fine of ₦100,000 or imprisonment not exceeding 2 years, or both.

7.9.5 Failure by banks to disclose information

Section 43 empowers the Federal Inland Revenue Service to request for and obtain both verbal and written information from any person whatsoever for the purpose of obtaining full information in respect of the profits of any company. The Revenue Service also has power to examine any documents, books, and accounts of any other person for the same purpose. Persons engaged in banking business in Nigeria are also covered under this Section except that the letter to such person(s) requesting for the information, documents, etc. must be signed by the Chairman of the Revenue Service.

Where any person engaged in banking in Nigeria fails to comply with the request of the Revenue Service for necessary information, documents,

etc. subsection (3) of Section 43 provides for the penalty. The penalty in respect of each offence is on conviction, a fine of ₦5,000 in the case of a body corporate, and a fine of ₦500 in the case of an individual.

7.9.6 Offences on Withholding Tax

Section 64 of CITA contains provisions relating to penalty for failure to deduct Withholding tax on rents, interests, royalties, dividends or that to be deducted under the provisions of Section 63. The penalty which is also applicable where the payer, having deducted the tax, fails to remit over to the Revenue Service within 30 days from the date the amount was deducted is, on conviction, a fine of 200% of the tax not withheld or not remitted as the case may be in addition to the amount of the tax deducted plus interest at the prevailing commercial rate.

7.9.7 Failure to pay tax on due date

When any tax is not paid on the due date a penalty of 10% per annum of the amount of the tax payable shall also become payable (Section 65(1)). The Revenue Service shall serve a demand notice on the company and payment is to be made within one month from the date of service. Subsection (2) of Section 65 makes it an offence for any company, without lawful justification or excuse, not to pay tax and the penalty within the period of one month from the date of service of the demand notice.

There is no specific provision in Section 65 for the penalty payable by any company found guilty of this offence. Therefore, in accordance with Section 71(1) a fine of ₦200,000 appears to be the only penalty applicable.

The Revenue Service may, for any good cause shown, remit the whole or any part of the addition due in respect of penalties and interest under Section 65(1). Section 65(3).

7.10 CHAPTER REVIEW

In this chapter, the detailed provisions as to persons chargeable to Companies Income Tax are discussed.

Penalties for different offences in the CITA are also discussed with special references to Withholding tax, Tertiary Education tax and Information Technology tax. It concludes by stating very clearly penalties for non-remittance of returns for the purpose of companies income tax, etc.

7.11 WORKED EXAMPLES

7.11.1 Questions

1. What are the specific offences and penalties under Federal Inland Revenue Service Act (FIRSA) 2007?

2. You have just been appointed as Tax Consultant to Bibishow Ltd, a company incorporated many years ago but has not rendered any tax returns to revenue authority. Issues relating to offences and penalties came up in one of your discussions with the Chief Executive Officer.

   Required:
   State the offences and penalties under Companies Income Tax Act CAP C21 LFN 2004 (as amended).

3. (a) What is the penalty prescribed under the tax laws for a person on whom a warrant of search is served and who refuses to cooperate?
   (b) State the conditions that can necessitate a relevant tax authority to consider search and seizure option on a taxpayer.

4. What are the penalties for late filing of Income tax returns for an ongoing business and late payment or non-payment of tax under the Companies Income Tax Act CAP C21 LFN 2004?

7.11.2 Suggesed Solutions

1. Specific Offences and Penalties under FIRSA 2007

Offences	Penalties
Failure to complete and deliver to the FIRS any return required or failure to produce books, documents, etc for examination at the place and time stated in the notice, or failure to appear personally before an officer of FIRS for examination or failure to give orally or in writing further information required.	Liable on conviction in respect of each offence to a fine of 100% of the amount of the tax liability.
Failure of a bank to furnish, upon demand by the FIRS, quarterly returns on the names and addresses of all customers of the bank connected with all transactions involving N5 million and above in the case of an individual or N10 million and above in the case of a body corporate or failure to submit returns on the names and addresses of new customers of the bank or any other additional information about its customers required by the FIRS.	Liable on conviction to a fine not exceeding N500,000 on corporate customers and not exceeding N50,000 in the case of an individual customers.
Failure to pay tax within the period prescribed.	Penalty of 10% of the amount of tax payable and: (a) in the case of Naira remittances, an interest at the prevailing minimum re-discount rate of the CBN plus spread to be determined by the Minister; (b) in the case of foreign currency remittances, an interest at the prevailing London Inter Bank Offered Rate (LIBOR) or the prevailing minimum re-discount rate of the CBN whichever is higher, plus spread to be determined by the Minister.The interest is on the tax due and runs from the date when the tax becomes payable until it is paid.

Offences	Penalties
Failure to deduct withholding tax or failure to pay withholding tax deducted to the FIRS within 30 days from the date of deduction or the date the duty to deduct arose.	Liable on conviction to pay the tax withheld or not remitted in addition to a penalty of 10% per annum of the tax withheld or not remitted and interest at the revailing CBN minimum rediscount rate and imprisonment for a period of not more than three years.
(a) Obstructing or assaulting an authorized officer in the exercise of his function. (b) Impeding the carrying out of any search, seizure, removal or distraint. (c) Rescuing, damaging or destroying anything liable to seizure, removal or distress. (d) Preventing the arrest of any person or rescuing any person so arrested.	Liable on conviction to a fine not exceeding N200,000 or imprisonment for a term not exceeding three years or both fine and imprisonment.
Making, signing and delivering any declaration, notice, certificate or other document or making a statement for the purpose of tax which is untrue in any material particular.	Liable on conviction to a fine not exceeding N200,000 in addition to payment of the amount of tax unpaid or overpayment made in respect of any repayment or to imprisonment for a term not exceeding three years or to both fine and imprisonment.
(a) Counterfeiting or falsifying any document required for tax purposes. (b) Accepting or using counterfeited or falsified document knowingly. (c) Altering any document after it is officially issued. (d) Counterfeiting any seal, signature, initial or other mark of, or used by, any officer for the verification of such a purpose relating to tax. (e) An employee of FIRS conspiring or participating in the commission of any of the offences in (a) to (d).	Liable on conviction to a fine not exceeding N200,000 or to imprisonment for a term not exceeding three years or to both such fine and imprisonment.

Offences	Penalties
Committing an offence under the Act while being armed with any offensive weapon.	Liable on conviction to imprisonment for a term not exceeding five years.

2. **Specific Offences and Penalties under CITA 2004**

Offences	Penalties
Failure to disclose information to the FIRS regarding the occurrence of certain events which should result in the withdrawal of investment allowance earlier granted. Such events include the sale or transfer or appropriation of asset on which investment allowance has been granted to another person or purpose other than a chargeable purpose within five years from the date of purchase of the asset.	Liable on conviction to a penalty not exceeding N100 plus the amount of tax lost as a result of granting the investment allowance.
Failure to file with the FIRS the company's audited accounts and returns within the stipulated time, that is, not late than 6 months after the close of the company's accounting year or in the case of a newly incorporated company, within 18 months from the date of incorporation or not later than 6 months after the end of its first accounting year, whichever is earlier.	The penalty on the company is: (a) N25,000 in the first month in which the failure occurs; and (b) N5,000 for each subsequent month in which the failure continues. The penalty on any director, manager, secretary or other similar officers, servant or a gent of the company who was a party to the offence being committed is a fine of N100,000 or imprisonment for two years or both.
Failure to deduct withholding tax on interest, royalty, rent, dividend, etc or failure to pay the tax deducted to the FIRS within 21 days from the date of deduction or the date the duty to deduct arose.	Liable to a penalty of 10% per annum of the tax not withheld or not remitted as the case may be in addition to the amount of tax deducted plus interest at the prevailing commercial rate.
Failure to pay any tax (i.e. provisional tax, self-assessment tax or tax charged	A penalty of 10% per annum of the amount of tax payable

Offences	Penalties
by assessment) on the due date.	plus interest at bank lending rate on the tax becomes payable until it is paid.
Collecting or attempting to collect companies income tax by an unauthorized person.	Liable on conviction to a fine of N600 or to imprisonment for three years or to both such fine and imprisonment.

3. (a) A person who refuses to cooperate or does any act which results in abuse or physical assault shall be guilty of an offence and liable on conviction to a fine of ₦200,000 or a term of imprisonment not exceeding 3 years or both.

(b) (i) Where a relevant tax authority is satisfied that there is a reasonable ground for suspecting that an offence involving any form of total or partial non-disclosure of information or any irregularity or an offence in connection with or in relation to tax has been committed.

(ii) Where a relevant tax authority is of the opinion that evidence of the offence or irregularity is to be found in the premises,the registered office or any other office or place of management of any trade;vocation;profession or business or in the residence of the principal officer; factor,agent or representative of the individual,the relevant tax authority may authirise any of its officers to enter,if necessary by force to conduct a search on such premises.

4. **Penalties for late filing of tax returns**

(a) For an ongoing business,failure to file tax returns as at when due or after 6 months following its accounting year end attracts a penalty of ₦25,000 for the first month in which the failure occurs and ₦5,000 for each subsequent month in which the failure continues-Section 55(3)(5) and Section 85(1) of CITA.

(b) Upon conviction,the responsible officer of the company may be liable to a fine of ₦100,000 or 2 years imprisonment or both.

CHAPTER 8

Taxation of Non-Residents

Contents

1. Purpose
2. Introduction and Concept of Residence
3. Resident Individual
4. Resident and Non-Resident Companies
5. Dual Residence
6. Branches and the Parent Company
7. Subsidiaries and the Parent Company
8. Comparison of Overseas Branch with Overseas Subsidiary
9. Treatment of Expenses
10. Profits or Income "Deemed to be derived from Nigeria"
11. Chapter Review
12. Worked Examples

8

TAXATION OF NON-RESIDENTS

8.0 PURPOSE

After studying this chapter, readers should be able to:

(a) identify what constitutes taxable income of non – residents;
(b) apply relevant provisions of the Nigerian tax laws in ascertaining the assessments of non-residents; and
(c) determine non-residents tax liability in Nigeria; and understand the procedure for payment of relevant tax.

8.1 INTRODUCTION

The concept of residence determines the extent to which the income of a taxpayer is liable to tax under a tax jurisdiction. In Nigeria, a resident person (individual or company) is assessable on the global income. This implies that the taxpayer is liable to tax on the income or profits **"accruing in, derived from, brought into, or received in Nigeria."** It also determines the scope of deductions that may be allowed for the purpose of computing an individual's chargeable income.

For income tax purposes, a person may be resident, non-resident or possess dual residence.

8.2 CHARGEABILITY TO TAX RESIDENT INDIVIDUALS

An individual is regarded as resident in Nigeria throughout an assessment year if he:

(a) Is domiciled in Nigeria;
(b) Sojourns in Nigeria for a period or periods in all amounting to 183 days or more in a 12 month period; or
(c) Serves as a diplomat or diplomatic agent in Nigeria.

8.2.1 Resident Individual and liability to Tax

(a) The profit of a trade, profession or vocation is liable to tax in Nigeria regardless of the period for which such a trade, profession or vocation has been carried on.
(b) Employment income is liable to tax on the basis of residence.

8.2.2 Non-resident individual

A non-resident individual is a person who is not domiciled in Nigeria or who stays in Nigeria for less than 183 days but derives income or profits from Nigeria. A non-resident individual becomes liable to tax from the day he commences to carry on a trade, business, vocation, or profession

in Nigeria. However, he is liable to tax in respect of employment income when he becomes resident.

A non-resident Individual shall be liable to tax in Nigeria to the following extent:-

(a) In case of earned income like trade, business, profession and vocation, they would be liable to tax in Nigeria in the hands of a non-resident to the extent of such income derived from Nigeria.
(b) In the case of unearned income like dividend, rent, interest and royalties, they would be liable to tax in Nigeria in the hands of a non-resident to the extent of such income received in or bought into Nigeria.
(c) In the case of employment income, a non-resident will only be liable to tax when he becomes resident in Nigeria. This means employment incomes are only liable to tax if the activities or duties for the employment are wholly or partly carried on in Nigeria. However, where the duties of employment are paid in Nigeria and there is an evidence that such salary has been subjected to tax been outside Nigeria, the tax shall be payable in Nigeria.

8.3 RESIDENT AND NON-RESIDENT COMPANIES

8.3.1 Resident Companies

A company is resident in Nigeria under the new law if it is incorporated or registered in Nigeria. Under the old provision, residence was being determined by place of management or control. This means that a company can be resident in Nigeria by incorporation and also resident in UK if it is managed and controlled in UK. This is known as international dual residence.

8.3.2 Non-Resident Companies

This is a company or corporation that is not registered or incorporated in Nigeria but which derives income or profits from Nigeria. It is to be mentioned here, for the sake of emphasis, that exemption from incorporation does not confer exemption from payment of tax on any company. Every company, resident and non-resident, is liable to tax in Nigeria if its income is liable to tax under the provisions of the Companies Income Tax Act CAP C21 LFN 2004 (as amended).

The following are the circumstances under which a non-resident company will be liable/assessable to tax in Nigeria.

(a) Income derived through a fixed base or permanent establishment.
(b) Income derived in Nigeria through a dependent agent.
(c) Income derived from supervisory activity that last more than three (3) months.
(d) Income derived in Nigeria from a Turn-Key Project.

(e) Income derived by non-resident company from professional consultancy, Management and technical services rendered in Nigeria. For this income, the withholding tax of 10% is taken as the final tax.
(f) Income derived by a non-resident company from investment such as dividend, interest, rent and royalties. The withholding tax deducted from these incomes is taken as the final tax.
(g) Income derived from a contract awarded to a Nigerian company but sub-contracted to a non-resident company.

8.4 DUAL RESIDENCE

An individual or company may have dual or multiple residence status.

8.4.1 Dual Residence or Individuals (Local)

Ordinarily, a resident individual is subject to tax in Nigeria in the State where the individual normally resides. In the case where such an individual has two or more places of residence in Nigeria for income purposes, he is subject to tax in the state where he has the **"principal place of residence."** The term **"principal place of residence"** means, for an individual with:

(a) Pension as the only source of earned income, his usual residence constitutes the principal place of residence;
(b) Sources of earned income other than pension, the place nearest to his usual place of work; and
(c) Sources of unearned income, his usual residence.
Where the determination of the principal place of residence leads to dispute between two or more tax authorities, the Joint Tax Board determines the tax jurisdiction. In practice, the determining factor is the source of earned income.

8.4.2 Local Dual Residence of a Company

The constitutional arrangement in Nigeria vested the taxation of all companies in the Federal tax authority. This does not allow for the dual residence of companies locally. All companies wherever located in Nigeria are under Federal tax jurisdiction. Therefore, the problem of local dual residence of companies does not arise.

8.4.3 International Dual Residence

The definition of the term "residence" differs from one country to the other. For instance, in Nigeria, the length of stay to qualify a taxpayer as a resident is reckoned within a 12month period. In some countries, this is reckoned within an assessment year-allowing for a qualifying period of stay to split over two years of assessment. In some other countries (e.g. the USA), the citizen is regarded as resident in the home country whatever the length of stay abroad. This creates the problem of dual residence for the individual who is regarded as resident in more

than one country. For example, he is regarded as resident at the same time in country A where nationality is the basis of residence, in country B where he has stayed for more than 183 days in a 12-month period and, may be, in his home country where he is away for less than 183 days in that assessment year.

A company may also have the problem of dual residence. For instance, the definition of the residence of a company in Nigeria is the place of incorporation. In some other countries, the relevant criterion may be the "place of management" or the "place of residence of the directors". In this instance, the Nigerian tax authority would treat the company as resident in Nigeria on the basis of the place of incorporation while the tax authority of the other country would regard the same company as resident in that other country on the basis of "place of management". The Nigerian tax treaties govern the treatment of such cases and affected companies can claim tax credit for the Nigerian tax in their home countries to avoid double taxation.

8.5 BRANCHES AND THE PARENT COMPANY

The tax laws of some countries regard a branch as resident, for tax purposes, in the same country as the parent company and therefore exempt the income of branches from tax. There is no such provision in the Nigerian tax law. A Nigerian branch of a foreign company is treated as a corporate entity under the law of the land and any income or profit derived by it from Nigeria is taxable here. The only two conditions where a branch may not be so treated are:

(a) If the branch is used solely for storage or display of goods or merchandise; and

(b) If the branch is used solely for the collection of information.

8.6 SUBSIDIARIES AND THE PARENT COMPANY

A subsidiary is expected to be incorporated in Nigeria and therefore to operate as a separate legal entity from the parent. The foreign equity-participation may now, in certain circumstances, be 100% but such equity-ownership or the control will not affect the residence status in Nigeria once the company incorporates. However, the claim to the contrary by the other country may raise all the problems of dual residence.

Article 4 of the Nigerian Model Double Taxation Agreement spells out the mode of resolving the problem of dual residence between Nigeria and a treaty-country.

The Agreement provides for the criterion of **"place of incorporation"** as basis of resolving dual residence of compliance. Where this fails, the question is to be resolved by **"mutual agreement"**.

8.7 COMPARISON OF OVERSEAS BRANCH WITH OVERSEAS SUBSIDIARY

8.7.1 Overseas Branch

For tax purposes, the profit of an overseas branch of a Nigerian company is deemed to be derived in Nigeria and is therefore fully liable to tax in Nigeria. Note that any foreign tax suffered is not allowable in determining the overseas profit. Also, assets in use in such a branch will be entitled to capital allowances claimed in Nigeria. Losses incurred from such a branch can be set off against profit in Nigeria provided the losses were incurred from the same source.

Double taxation relief is available for any foreign tax suffered either based on bilateral agreement or based on tax relief available under the common wealth.

8.7.2 Overseas Subsidiary

For tax purposes, the profit of an overseas subsidiary is not deemed to be derived in Nigeria and will therefore not be liable to tax in Nigeria. It is only dividend received from such overseas subsidiary that will be considered for Nigeria tax purposes. Also technical and management fees paid to the Nigerian company by the overseas subsidiary will be subjected to tax in Nigeria. Note that capital allowance will not be claimable on the assets of the overseas subsidiary. Loss can also not be relieved since there is no group taxation in the Nigerian tax law.

8.8 TREATMENT OF EXPENSES

The Nigerian tax laws do not discriminate between residents and non-residents in the allowance of expenses for the purpose of determining the taxable income. All expenses proved to be incurred for the production of the income are allowable as deductions. Rent, interest, royalties, management fees, head office expenses and similar expenses are deductible if proved that they are "wholly, exclusively, necessarily and reasonably" incurred for the purpose of the trade or business.

8.9 PROFITS OR INCOME "DEEMED TO BE DERIVED FROM NIGERIA"

Under the old law, the liability to the Nigerian tax on the income from a trade or business of a non-resident company or individual in Nigeria was restricted to that portion of the income attributable to the operations performed in Nigeria. This definition has been found to be inadequate in view of the growing complexities in the nature of commercial operations in Nigeria. The government is in favour of encouraging foreign investment and has therefore decided to state in clear and specific terms which activities of a non-resident company and individual would attract Nigerian tax and to what extent. Recent amendments to the tax laws have comprehensively defined what constitutes the deemed profit or income from a trade or business carried on in Nigeria.

For companies, answers to the following questions will determine whether or not an income is deemed to be derived from Nigeria:

(a) Does the company have a "fixed base" in Nigeria?
(b) Does the company operate in Nigeria through a dependent agent authorized to?
(c) Is the company executing a turnkey project in Nigeria? Or
(d) Is the operation between the company and its Nigerian subsidiary at arm's length?

These specific circumstances will be treated in turns.

8.9.1 Fixed Base of Business

If a non-resident company has a **"fixed base"** from which it carries on its business or trade in Nigeria, the profits from such activities would be deemed to be derived from Nigeria.

The term **"fixed base"** implies that the place must be easily identifiable and must possess some degree of permanence. It includes:

(a) facilities such as a factory, an office, a branch, a mine, gas or oil will, etc;
(b) activities such as building, construction, assembly, or installation; and
(c) furnishing of services in connection with the activities mentioned above.

However, two cases are specifically exempted and these include:

(i) facilities used solely for storage or display of goods or merchandise; and
(ii) facilities used solely for the collection of information.

8.9.2 Operation of a Dependent Agent

A non-resident company can have two types of agents in Nigeria – an independent agent or a dependent agent. An agent is regarded as possessing independent status when he acts on behalf of a non-resident company in the ordinary course of his business. The status may however change if he devotes his activities wholly or almost wholly on behalf of the company.

Where a dependent agent makes an isolated sale of goods on behalf of a principal, that may not necessarily constitute the income from such an operation, the deemed profit is liable to Nigerian tax. However, where the facts show that the sale of goods on behalf of the principal or of any company associated to it by the agent is on a regular pattern, this arrangement will conform with the intention of the term **"habitually"**.

8.9.3 Profits on a TurnKey Project

A turnkey project is defined as a "single contract involving survey, deliveries, installation or construction." The profit on a turnkey project is liable to tax in Nigeria. Such a profit should not be split between the so-called "Nigerian source" and "off-shore" profits but taxed wholly in Nigeria.

8.9.4 Transactions not at Arm's Length

The legislation allows the Board to make appropriate adjustment to the profits of a Nigerian companies where the following circumstances prevail:

(a) where there is a controlling interest in the Nigerian company;

(b) the presence of a control of a Nigerian company may be exercised directly or indirectly by a parent company or any other company associated to it;

(c) the imposition of conditions in the financial and commercial relationship by the controlling interest;

(d) the conditions imposed must be different from what would obtain between independent parties or in an open market situation;

(e) Such relationship and conditions lead to the transfer of goods and services at prices not at arm's length; and

(f) Consequently, the profits declared for the Nigerian tax are understated.

The 'imposition of conditions' or control and influence as mentioned above can move in various appearances like over-invoice of goods and services, packaging of the terms of payment of interest on loans, frivolous charges for management fees, royalty, patent and rent, convenient shifting of profits between companies or in the allocation of expenses, all with the objective of minimizing, avoiding or evading the Nigerian tax.

When the conditions analysed above hold, the profit deemed to be derived from Nigeria shall be as determined by the Board. In such circumstance, the Board will carry out comparative cost and price to establish the true market prices and make necessary adjustments to determine the true profit for tax purposes.

8.9.5 "Sales' Outlet"

The law has excluded:

(a) "facilities used solely for storage of goods or merchandise"; and

(b) "facilities used solely for the collection of information" from the facilities that would constitute a fixed base. The use of the word "solely" in the law implies that facilities used exclusively as a representative office would be exempted. Where, however, a facility is so exempted but such a facility will qualify as a "sales' outlet" and treated as a fixed base for the non-resident company. The profit arising from such a sales outlet is taxable.

Illustration 8.1

Sweet Home Inc has a representative branch in Nigeria for the display of its products. It was later discovered that sales were regularly conducted from the stock held for the display.

Suggested Solution 8.1

With the activity of the branch restricted solely to the display of the parent's in Nigeria, the branch will retain the status of a representative office and will not be held liable to Nigerian tax. However, with the sales activity of the branch, the status of the branch has changed to a sales' outlet and this will turn it into the parent's fixed base in Nigeria.

8.9.6 Employment Income

Residence is the basis of taxing employment income in Nigeria. The taxpayer is regarded as resident in Nigeria, his employment income is liable to Nigerian tax. The other conditions are as per paragraph below.

For employment income not to be liable to Nigerian tax, three conditions must hold viz:

(a) the employee must be resident for less than 6 months in any 12-month period;

(b) the employer of the person must not be resident in Nigeria; and

(c) income of the person must conform with the "subject-to-tax" principle.

8.10 CHAPTER REVIEW

In this chapter, the detailed provisions concerning the taxable income of non-residents both individuals and companies are discussed.

Also addressed is the dual residence of individuals, local and international companies.

8.11 WORKED EXAMPLES

8.11.1 Questions

1. John Agwu & Co. Ltd is a firm of medical practitioners with a clinic in Lagos. The business went down in 2007 to the extent that the operation had to be extended to a neighbouring commonwealth country. The results of his business operations for the year ended 31 December 2007, for both domestic and foreign transactions as follows:

	Lagos Clinic	Foreign Clinic	Total
	₦	₦	₦
Fees	1,500,000	5,000,000	6,500,000
Sales of drugs	850,000	2,500,000	3,350,000
	2,350,000	7,500,000	9,850,000
Less: Expenses			
Staff salaries	920,000	1,500,000	2,420,000
Electricity & rates	15,000	250,000	265,000
Motor vehicle maintenance	45,000	55,000	100,000
Depreciation of Asset	145,000	250,000	395,000
Purchase of drugs	450,000	500,000	950,000
Bank charges & interest	50,000	17,000	67,000
Foreign taxes suffered	-	1,510,000	1,510,000
Miscellaneous expenses	150,000	250,000	400,000
	1,775,000	4,332,000	6,107,000
Profit	**575,000**	**3,168,000**	**3,743,000**

(a) The capital allowance of ₦1,450,000 was agreed with the Federal Inland Revenue Service.

(b) The Company is a wholly Nigerian Company.

Required:

Compute the tax liabilities on the Total income stating clearly the double tax relief applicable to the company.

2. (a) To what extent are non-resident individuals liable to Nigerian Income Tax?

   (b) Explain briefly:

   (i) Resident Company

   (ii) Non-Resident Company.

3. Robertson Andersen Incorporated of New Jersey, USA has R&A Nigeria Limited as its subsidiary in Nigeria. In 2007, the Federal Government of Nigeria awarded a contract to the foreign company for the construction of an Export Processing Zone located in the South East of Nigeria for the

sum of $12 million. It decided for the sake of convenience to execute the contract through R & A Nigeria Limited.

The following are the expenses incurred for the execution of the contract.

	₦
Materials and other inputs	334,957,750
Hire of dredger	186,553,750
Foreign experts costs	156,785,500
Personnel costs	157,689,250
Other administrative costs	115,546,750

Additional information:

(i) A similar dredger is available for hire at ₦178 million at Bomil Limited.

(ii) The cost of foreign experts in carrying out similar assignments in the other zones has been established to be an average of ₦120.50 million.

(iii) Included in other administrative costs are management fees of ₦45 million. It was proved to have been wholly, exclusively, reasonably and necessarily incurred for the Nigerian contract.

(iv) Capital allowance was agreed at ₦74,221,750.

(v) The exchange rate is assumed to be ₦90 per $1.

Required:

(a) Compute the tax payable by the company for the relevant tax year.

(b) Discuss the issue of turnover assessment for a non-resident company in Nigeria.

4. The Companies Income Tax Act CAP C21 LFN 2004 (as amended) provides three tests for determining whether the profits of a non-resident company from any trade or business shall be deemed to be derived from or accrue in Nigeria. These tests are: the fixed base test; the agency test; and the turnkey contract test.

Required:

Explain in detail the meaning and implication of each test on liability to tax of a non-resident company.

8.11.2 Suggested Solutions

1. **John Agwu & Co. Ltd**
Computation of Adjusted Profit for 2008

	₦	₦
Net Profit as per Accounts		3,743,000
Add back:		
Depreciation of assets	395,000	
Foreign tax suffered	1,510,000	1,905,000
Assessable Profit		5,648,000

Income Tax Computation for John Agwu & Co. Ltd.

	₦	₦
Assessable Profit		5,648,000
Capital Allowance	1,450,000	
C/A Relieved	(1,450,000)	(1,450,000)
	NIL	
Total Profit		4,198,000
Income tax @ 30%		1,259,400
Less: Double Tax Relief (15% of ₦4,928,000)		(739,200)
Final Tax Liability		520,200

Computation of Adjusted Profit for Foreign Business

	₦	₦
Net Profit per Foreign a/cs		3,168,000
Add back:		
Depreciation	250,000	
Foreign Tax	1,510,000	1,760,000
Adjusted Profit		4,928,000

Commonwealth rate of tax $= \frac{1,510,000}{4,928,000} \times 100$

$= 32.6\%$

Nigerian Rate = 30%

Since Commonwealth rate of tax exceeds one half of Nigerian Rate, the Nigerian rate is applicable for double tax relief.

2. (a) Non-resident individuals are liable to tax in Nigeria to the extent that the income is derived from, accruing in, brought into or received in Nigeria. Simply put, this means that if an individual derives income from earning on a trade or business in Nigeria, aside from the business carried on in the other parts of the world, the income chargeable to tax in Nigeria is limited only to those incomes derived from the Nigerian operations.

In a similar manner, if an individual derives investment income from outside Nigeria but is not repatriated into Nigeria, no tax liability will arise in the hands of such a non-resident. The investment income is only charged to Nigerian tax if it is brought into Nigeria.

(b) Resident Company
A company is deemed to be resident in Nigeria if it is incorporated or registered in Nigeria.

(c) Non-Resident Company
A company is said to be a non-resident if such company is not registered or incorporated in Nigeria but derives income or profit from Nigeria.

3. (a) Robertson Andersen Incorporated
Computation of Tax Payable for 2008 Tax Year

	₦	₦
Turnover ($12 million x ₦90)		1,080,000,000
Deduct:		
Materials and other inputs	334,957,750	
Hire of Dredger	178,000,000	(512,957,750)
		567,042,250
Personnel Costs	157,689,250	
Foreign Experts costs	120,500,000	
Other administrative costs	115,546,750	393,736,000
Assessable Profit		174,221,750
Capital Allowance	74,221,750	
C/A Relieved	(74,221,750)	(74,221,750)
	NIL	
Taxable Profit		**100,000,000**
Tax Payable @ 30%		**30,000,000**
Tertiary Education Tax @ 2%		**3,484,435**

(b) The policy of the Federal inland Revenue Service in the determination of the fair and reasonable percentage of the turnover of Non-Resident company are as follows:

(i) where the activities carried on through a fixed base involved in construction, assembly or installation, or in the case of turnkey projects, the percentage of the turnover to be adopted to determine the assessable profit of 10%. The capital allowances are deemed to have been granted and at the current tax rate of 30%, this gives an effective rate of 3.0% of turnover.

(ii) where the activity carried on through the fixed base or through the dependent agent involves consultancy, management, Technical or agency services, the 10 percent withholding tax is final.

4. The Key tests in the taxation of non-residents include:

(a) **FIXED BASE OF BUSINESS – S. 11 (2)(a)**

The fixed base of non-resident company is the place from where it carries on its business or trade in Nigeria. The fixed base must be easily identifiable and must possess some degree of permanence. A fixed base will include:

(i) Facilities such as a factory, an office, a branch, a mine or an oil well;
(ii) Activities such as building, construction, assembly or installation; and
(iii) Furnishing of services in connection with the activities above. It is important to note that the following cannot be considered as a fixed base:
- Facilities used solely for storage or display of goods or merchandise;
- Facilities used solely for the collection of information.

For an individual, the profit of an individual carrying on a trade or business in Nigeria through a fixed base shall be the profit attributable to that fixed base specifically:

- If the business is through a dependent agent, the profit attributable to that agent;
- If the business involves turnkey projects, the profit from that contract;
- If the business as through related parties, the profit determined on arms length principle by the relevant tax authority.

(b) **AGENCY OPERATION – S. 11 (2)(b)**

Where a non-resident does not have a fixed base in Nigeria but habitually operates a trade or business through a person in Nigeria:

(i) Authorized to conclude contracts on its behalf or on behalf of some other companies controlled by it or which has controlling interest in them.

(ii) Who habitually maintains a stock of goods or merchandise in Nigeria from which deliveries are regularly made by a person on behalf of the company, then an agency arrangement is deemed to have arisen. The profit deemed to have been derived from Nigeria is the profit attributable to the business or trade or activities carried on through the agent.

There may be two types of agents:

- **Independent agent:** an agent is regarded as possessing independent status when it deals on behalf of a non-resident company in its ordinary course of its own business. The implication of this arrangement is that the agent carries on its own trade along with his function as an agent of the non-resident company. Therefore, if the non-resident company stops trading in Nigeria, the independent agent is not materially affected as it will continue in its own business.

- **Dependent agent:** this occurs where the agent devotes his activities wholly or almost wholly on behalf of the non-resident company. Where a dependent agent makes an isolated sale of goods on behalf of the principal, such a profit may not necessarily be subjected to tax in Nigeria. Where however the sale of goods on behalf of the principal is on a regular basis, then the agent is deemed to trade habitually in the goods and the profit derived therefore is chargeable to tax in Nigeria.

(c) **TURNKEY PROJECTS – S. 11(2)(c)**

This is a trade or business or activity which involves a single contract for the surveys, deliveries, installations or construction. For Nigerian income tax purposes, the profit from such a turnkey project is considered as derived from Nigeria. Consequently, it is fully chargeable to tax in Nigeria because no allowance would be given for the profit to be divided into Nigerian and offshore.

CHAPTER 9

Pioneer Legislation

Contents

1. Purpose
2. Introduction
3. Pioneer Conditions
4. Application for Pioneer Status
5. Production Day
6. Certification of Qualifying Capital Expenditure
7. Cancellation of Pioneer Certificate
8. Income Tax Relief
9. Exempt Profits and Dividends Therefrom
10. Offences and Penalties
11. Section 25 (IDA)
12. Nigeria LNG Limited
13. Chapter Review
14. Worked Examples

9

PIONEER LEGISLATION

9.0 PURPOSE

After studying this chapter, readers should be able to:

(a) understand the major provisions of The Industrial Development (Income Tax Relief) Act, 1971 (IDA) and how they apply to tax computations of pioneer companies;
(b) identify what pioneer conditions for pioneer status;
(c) how the importance of production day is to a pioneer company;
(d) understand the income tax relief available to pioneer companies and the duration; and
(e) be able to prepare income tax computations applying the provisions of CITA and IDA.

9.1 INTRODUCTION

One of the investment incentives available to industries in Nigeria is contained in the Industrial Development (Income Tax Relief) Act, which grants tax holidays to companies in the industries that meet the conditions for being designated "Pioneer Industries". The tax holiday is usually for an initial period of three years but can be extended for an additional two years maximum.

The Industrial Development (Income Tax Relief) Act 1971 (IDA 1971), came into force on 1 April 1970.

9.2 PIONEER CONDITIONS

Where the National Council of Ministers (the Council) is satisfied that:

(a) Any industry is not being carried on in Nigeria on a scale suitable to the economic requirements of Nigeria, or there are favourable prospects of further development in Nigeria of any industry; or
(b) It is expedient in the public interest to encourage the development or establishment of any industry in Nigeria, it may declare the Industry a Pioneer Industry, and products of the Industry - Pioneer Products.

Application may at any time be made for the issue of a Pioneer Certificate to any company in relation to any such pioneer industry or pioneer product. Each application shall be accompanied by a non-refundable fee of ₦100 (one hundred Naira only).

A company that wishes to engage in an industry or manufacture products which have not been designated as pioneer may submit an application for the industry to be included in the list of pioneer industries and its products to be included on the list of pioneer products.

A successful applicant in either case is issued with a pioneer certificate in which conditions under which the income tax relief can be enjoyed is stated.

For any application for a pioneer certificate to be considered, the estimated cost of qualifying capital expenditure to be incurred by the company on or before production day shall not be less than:
(a) ₦50,000 in the case of an indigenous-controlled company; or
(b) ₦150,000 in the case of any other company.

9.3 APPLICATION FOR PIONEER STATUS

Application for pioneer status can be made by a company incorporated in Nigeria or by a group of persons on behalf of a company which is to be incorporated later. The application shall be on a prescribed form.
Every such application shall state the grounds upon which the applicant relies and if the application is for the issue of a pioneer certificate to any company, the applicant shall:
(a) State whether the company is, or the proposed company when incorporated, shall be an indigenous-controlled company;
(b) Give 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, and
 (ii) During a period of three years following the production day;
(c) Specify the place in which the assets are to be situated;
(d) State the probable production day;
(e) Specify any product and by-product (not being a pioneer product) to be produced, and 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) Give particulars of the loan and share capital (or proposal in this regard) including the amount and date of each issue and the source 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 and the number of shares held by him/ her; and
(h) In the case of a proposed company, give the name, address and nationality of each promoter of the company.

9.4 PRODUCTION DAY

Subsection (1) of Section 6 of IDA requires that not later than one month after the material date, a pioneer company shall make an application in writing to the Industrial Inspectorate Director to certify the date of its Production Day. The company shall propose a date to be so certified and give reasons for proposing that date.

For the purpose of this subsection, “material date” means –

(a) In relation to a pioneer company engaged in a pioneer industry consisting of the provision of services, the date on which the company is ready to provide such services on a commercial scale; and

(b) In case of manufacturing, processing, mining, agricultural or any other pioneer industry, the date on which the company begins to produce a pioneer product in marketable quantities.

After considering any application made as above, together with such information as may be called for, the Director shall issue a certificate to the pioneer company certifying the date of its production day.

It is to be noted that the period of the tax holiday shall commence from the production day. Dispute between the company and the Director as to the certification of the production day shall be subject to objection and appeals as if the certificate were a Notice of assessment given under the provisions of CITA.

9.5 CERTIFICATION OF QUALIFYING CAPITAL EXPENDITURE

Not later than one month after the production day of a pioneer company has been finally determined and certified by the Director or within such extended time as the Revenue Service may allow, a pioneer company shall make an application in writing to the Revenue Service to certify the amount of the qualifying capital expenditure incurred by the company prior to production day.

The proceeds of disposal of any item of capital expenditure disposed of prior to the production day shall be deducted from the total amount of capital expenditure incurred to arrive at the amount to be certified. Also, if any of such disposal has not been made at arm's length, the open market value on the date of the disposal shall be substituted for the disposal proceeds.

After considering the application made for the certification of qualifying capital expenditure as above together with such information as may be requested, the Revenue Service shall issue a certificate to the pioneer company certifying the amount of qualifying capital expenditure incurred by the company prior to production date.

If there is any dispute between the Revenue Service and the company in connection with the certification of the qualifying capital expenditure, such shall be subject to objection and appeal procedures as if the certificate were a notice of assessment given under the provisions of CITA.

9.6 CANCELLATION OF PIONEER CERTIFICATE

The pioneer certificate issued to any company can be cancelled if:

(a) The production day has been certified as on a date which is more than one year later than the estimate thereof given in the company's application for a pioneer certificate. However, the council will not cancel the certificate for this reason if it is satisfied that the delay is due to causes outside the control of the company or to other good and sufficient cause.

(b) The certificate of qualifying capital expenditure as on the production day is to the effect that the amount of qualifying capital expenditure incurred as on that day is less than the prescribed minimum applicable to the company.

(c) The pioneer company concerned applies for the cancellation of the certificate.

(d) A pioneer company has contravened any other provision of the IDA or has failed to fulfil any estimate or proposal made in its application for a pioneer certificate or any of the conditions contained in its pioneer certificate.

9.7 INCOME TAX RELIEF

A company holding a pioneer certificate shall be on a tax holiday for the period stated on the certificate. The tax relief period is usually for a period of three years in the first instance, commencing on the date of the production day of the company, unless cancelled or restricted in any manner by the council.

If certain requirements are met, the council may, at the end of the three years extend the tax relief period for –

(a) Two periods of one year each; or

(b) One period of two years.

A pioneer company wishing to obtain such extension, shall apply in writing within one month of the expiration of the initial three years tax relief period or of any extension thereof. Such application shall contain details of all capital expenditure incurred by the company by the requisite date. The requisite date is the date of expiry of a pioneer certificate.

Taxation implications and accounts:

(a) A trade or business carried on by a pioneer company shall be deemed to have permanently ceased at the end of its tax relief period.

(b) In respect of that trade or business, the pioneer company shall be deemed to have set up and commenced a new trade or business on the day next following the end of its tax relief period.

(c) The pioneer company shall make up accounts of its old trade or business for the following:

(i) a period not exceeding one year commencing on its production day,
(ii) successive periods of one year thereafter; and
(iii) a period not exceeding one year ending at the date when its tax relief period ends.

(d) The closing figures in respect of the pioneer company's assets and liabilities as shown in the last accounts in respect of its tax relief period shall be used as the opening figures for the accounts of the company's new trade or business which is that deemed to commence immediately after the company's tax relief period.

(e) Capital expenditure incurred by the pioneer company in respect of assets acquired during the tax relief period shall for capital allowances purposes be deemed to have been incurred on the day next following the end of its tax relief period.

Losses

Where the Revenue Service is satisfied that a pioneer company has incurred a loss in any accounting period within the tax relief period, it shall issue a certificate to the company accordingly. (IDA Section 10(6)).
In determining whether such a loss has been made, the Revenue Service may in its absolute discretion exclude such sum as may be in excess of an amount appearing to the Revenue Service to be just and reasonable in respect of –

(a) remuneration to directors of the company;
(b) interest, service, agency or other similar charges made by a person who is a shareholder of the company or by a person controlled by such shareholder (IDA Section 13(3)).

A net loss incurred by a pioneer company shall be deemed to have been incurred by the company on the day on which its new trade or business commences, that is, on the day following the expiry of the tax relief period (IDA Section 14(3)).

For each accounting period, the Revenue Service shall issue to the pioneer company a statement showing the amount of the income or loss for that period. Net loss means the aggregate of losses incurred during the tax relief period after deduction of profits, if any, made at any time during that period.

Any dispute between the Revenue Service and the Company with regards to the statement of income or loss issued by the Revenue Service shall be subject to objection and appeal in like manner as if such statement were an assessment under CITA.

Taxable profits

Any profit earned by a pioneer company from any operations or activities whatsoever, other than its pioneer enterprises shall be deemed to be derived from Nigeria and shall be liable to tax under CITA.

Service Charge

A service charge of 2% based on the projected tax savings is payable to the Nigeria Investment Promotion Commission during application as contained in Pioneer Status Incentive Regulation 2014.

9.8 EXEMPT PROFITS AND DIVIDENDS THEREFROM

Exempt profits

Any profits shown on the statement issued by the Revenue Service in respect of the income of a pioneer company for each of the accounting periods of its tax relief period shall not form part of the Assessable profits or Total profits of the pioneer company for any year of assessment and shall be exempt from tax under CITA – (IDA Section 16).

Dividend distribution

Any amount of profits that is exempt from tax as above should be credited by the pioneer company to an account to be kept for the purpose of dividend distribution by the company.

Any dividend that is declared by the company out of such profits shall be exempt from tax in the hands of the shareholders and shall for the purposes of CITA and PITA be deemed to be paid out of profits on which tax is not paid or payable.

Prohibitions (Section 18)

During its tax relief period, a pioneer company shall not –

(a) Make any distribution to its shareholders, by way of dividend or bonus, in excess of the amount by which the account maintained for the exempt profits is in credit at the date of such distribution.

(b) Grant any loan without first obtaining the consent of the Minister. The consent of the Minister shall only be given if he is satisfied that the pioneer company is obtaining adequate security and a reasonable interest for any such loan.

9.9 OFFENCES AND PENALTIES

Offences

The offences specified in IDA are:

(a) Making or presenting any declaration or statement which is false in any material particular; and

(b) Production of any invoice or undertaking which is false in any material particular or has not been given by the person by whom it is purported to have been given or which has been altered or tampered with.

The defence available to any person charged is to be able to prove that he has taken all reasonable steps to ascertain the truth of the statement made or contained in any document so presented or produced or to satisfy himself of the genuineness of the invoice or undertaking.

Penalties

Any person who is guilty of any of the above offences, shall be liable on conviction to a fine not exceeding ₦1,000 or to imprisonment for five years or to both such fine and imprisonment.

Where the offence is committed by a body corporate, or firm or other association of individuals:

(a) every director, manager, secretary or other similar officer of the body corporate;

(b) every partner or officer of the firm;

(c) every person concerned in the affairs of the association; or

(d) every person who was purporting to act in any such capacity as aforesaid, shall severally be guilty of that offence and liable to be prosecuted and punished for the offence in like manner as if he had himself committed the offence. The defence available to any of such persons is to be able to prove that the act or omission constituting the offence took place without his knowledge, consent or connivance. The above shall not relieve any person from liability to payment of any sum for which he is or may be liable under any undertaking given by him under any provision of the IDA.

9.10 SECTION 25 (IDA)

The terms defined in Section 25 of IDA and their respective meanings are reproduced below:

Accounting Period: A period for which accounts have been made up in accordance with the requirement of paragraph (c) of Section 11 of IDA;

Revenue Service: The Federal Revenue Service of Inland Revenue established under CITA;

Company: a company (other than a private company) limited by shares and incorporated and registered in Nigeria and resident in Nigeria;

The Council: The National Council of Ministers (Federal Executive Council);

The Director: The director appointed pursuant to Section 1(3) of the Industrial Inspectorate Act;

Gazette: The Federal Gazette and includes the Gazette of any state in the Federation;

The Minister: the Minister for industries;

or Business: The trade or business of a pioneer company deemed to have been set up and commenced on the day following the end of its tax relief period; old trade or

Business: The trade or business of a pioneer company carried on by it during its tax relief period which either ceases within

	that period or is deemed to cease at the end of that period permissible;
By-product:	Any goods or services so described in any pioneer certificate being goods or services necessarily or ordinarily produced in the course of producing a pioneer product;
Pioneer Certificate:	A certificate given under IDA certifying, among other things, a company to be a pioneer company;
Pioneer Company:	A company certified by any pioneer certificate to be a pioneer company;
Pioneer Enterprise:	In relation to a pioneer company, means the production and sale of its relevant pioneer product or products;
Pioneer Industry:	Any trade or business of the kind included in any list of pioneer industries published in the Gazette;
Pioneer Product:	Goods or service of the kind included in any list of pioneer products published in the Gazette;
Principal Act:	The Companies Income Tax Act;
Production Day:	The day on which the trade or business of a pioneer company commences for the purpose of CITA;
Qualifying Capital Expenditure:	Capital expenditure of such a nature as to rank as Qualifying expenditure for capital allowances purposes of the principal Act;
Product:	The pioneer product or products and the permissible by-relevant pioneer product or products specified in the pioneer certificate of any company;
Tax Relief Period:	The period specified under subsection (1) of Section 10 of IDA and any extension of that period made under that Section.

9.11 NIGERIA LNG LIMITED

The Nigeria LNG (Fiscal Incentives, Guarantees & Assurances) Act No. 39 of 1990 (amended by Act 113 of 1993) was promulgated to encourage productive disposal of associated gas and development of gas wells. The Decree applies to Nigeria LNG Limited alone. The incentives granted to the company are:

(a) The company is declared a pioneer company and its products pioneer products.
(b) Ten years tax relief period.
(c) All interests payable are allowable deductions for tax purposes without any condition.
(d) Interests on foreign loans are exempt from taxation in Nigeria.
(e) The books and records of the company shall be kept in United States dollars and the accounts therefrom shall be drawn in the same currency.
(f) Dividends are exempt from tax (like dividends payable by any other pioneer company from profits made during the tax holiday).
(g) Import duties exemption on necessary imports.
(h) No capital allowances restriction after its tax relief period.

In 2003, pioneer status was granted to certain companies operating in the telecommunication industry.

9.12 CHAPTER REVIEW

In this chapter, the various provisions of the Industrial Development (Income Tax Relief) Act (IDA) have been covered with regards to pioneer industries and pioneer companies. Pioneer conditions have also been discussed. The tax implications of a company that has been granted a pioneer status and the accounts to be prepared and submitted to the tax office for the purpose of claiming the benefits available to the pioneer company have been treated. Finally, the profits and dividends of a pioneer company are tax exempt.

9.13 WORKED EXAMPLES

9.13.1 Questions

1. New Idea Processing Co. Ltd. was established in 1988 and commenced its cocoa processing business on 1 July in the same year.
The adjusted profits of the company are as stated below:

		₦	
Period to	30 September 1989	600,000	Loss
Year ended	30 September 1990	1,500,000	Profit
Year ended	30 September 1991	2,750,000	Profit

Capital allowances for the relevant years of assessment were computed and agreed with the Federal Inland Revenue Service as follows:

	₦
1988 Year of Assessment	750,000
1989 Year of Assessment	600,000
1990 Year of Assessment	700,000
1991 Year of Assessment	550,000
1992 Year of Assessment	480,000

Required:
Determine the tax liability of the company for all the relevant years. Please note that the company was denied pioneer status.

2. Jayne Nigeria Limited was incorporated on 31 March 1994 to manufacture a pioneer product. It was granted a pioneer certificate with a production day certified to be 1 June 1994.

You are given the following information.

	₦
Net profit for the year ended 31 May 1998	1,540,000
Depreciation charged for year ended 31 May 1998	132,145
Capital expenditure incurred up to and including year ended 31 May 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 31 May 1997	725,000

It is not the intention of the directors to apply for an extension of the pioneer period.

Required:
Compute the tax liabilities for the relevant assessment years.

3. With respect to Industrial Development (Income Tax Relief) Act, discuss the following:
   (a) Restriction on trading prior to end of tax relief period
   (b) Restriction on distribution of dividend and granting of loans
   (c) Provision for plantation industry
   (d) Accounting periods

4. Deelbest Works Limited was incorporated in November 2005, as an indigenously controlled company for manufacturing shoe polish from cocoa pod. The company was granted a pioneer certificate in January 2006 for three years. The relevant operating results of the company for the first four years of operations are:

31 December:	2006	2007	2008	2009
	₦'000	₦'000	₦'000	₦'000
Gross Profit	4,000	16,000	14,000	15,000
Add: Profit on sale of assets	-	3,400	5,000	-
Less:				
Staff cost	(2,100)	(2,100)	(2,500)	(3,100)
Depreciation	(900)	(1,880)	(1,500)	(1,700)
Rent	(1,200)	(1,310)	(2,300)	(2,300)
General expenses	(1,300)	(2,410)	(2,900)	(2,810)
Operating Profit/(Loss)	(1,500)	11,700	9,800	5,090

Additional information supplied include:

(i) The company declared a total dividend of ₦10 million on 2007 financial statements and another dividend of ₦10 million in 2008.

(ii) The schedule of assets acquisition and disposals for the period are:

Year of Acquisition	Year of Disposal	Nature of Asset	Cash/(Proceeds) ₦
2006		Motor vehicles (6 items)	1,920,000
2006	2007	Motor vehicles (4 Items)	(4,080,000)
2007	-	Buildings	950,000
2007	-	Machinery (2 units)	810,000
2007	2008	Machinery (1 unit)	(5,410,000)

(iii) The Managing Director of the company who was on a salary of N700,000 per annum had 60% of shareholding interest of the company on which the dividends were paid in 2007 and 2008 financial statements.

(iv) The pioneer period of the company was not extended beyond December 2008.

Required:
Compute the income tax liabilities of the company for 2006 to 2009 Assessment years. Please show workings.

9.13.2 Suggested Solutions

1. NEW IDEA PROCESSING CO. LTD.
INCOME TAX COMPUTATION

Date of commencement of business – 1 July 1988
Commencement provisions:

Assessment Year	*Without election Basis Period*	*With election Basis Period*
1988	1/7/88 to 31/12/88	1/7/88 to 31/12/88
1989	1/7/88 to 30/6/89	1/1/89 to 31/12/89
1990	1/7/88 to 30/6/89	1/1/90 to 31/12/90
1991	Year ended 30/9/90	Year ended 30/9/90
1992	Year ended 30/9/91	Year ended 30/9/91

Without Election

	₦	₦
1988		
6/15 x ₦600,000 Loss c/f		(240,000)
Therefore, 1988 Assessment		NIL
Capital allowance unutilised c/f	750,000	
1989		
12/15 x 600,000 Loss		(480,000)
Therefore 1989 Assessment		NIL
Loss b/f	240,000	
For 1989 assessment year	480,000	
	720,000	
Loss c/f cannot exceed the amount of the actual loss incurred. Therefore loss c/f		₦600,000
Capital allowances:		
For year	600,000	
Brought forward	750,000	
Carried forward	1,350,000	
1990		
12/15 x ₦600,000 Loss		(480,000)
Therefore, 1990 assessment		NIL
Capital allowances		
For year	700,000	
Brought forward	1,350,000	
Carried forward		2,050,000
Loss c/f can still not exceed the actual loss incurred. Therefore, Loss c/f		600,000
1991		
Adjusted profit for the year ended 309/90		1,500,000
Less loss relief – Loss b/f		600,000
		900,000
Less Capital allowances:		
For year	550,000	
Brought forward	2,050,000	
	2,600,000	
Amount that can be relieved	(900,000)	(900,000)
C.A. unrelieved c/f	1,700,000	

	₦	₦
1991 Assessment		NIL
1992		
Adjusted profit for the year ended 30/9/91		2,750,000
Less Capital allowances:		
For year	480,000	
Brought forward	1,700,000	(2,180,000)
Chargeable profit		570,000
Income tax at 30% thereof		171,000

With election to have 2 and 3 years of assessment based on actual, the assessments for 1989 and 1990 assessment years would be:

	₦	
1989 – 1/1/89 to 31/12/89		
9/15 x (₦600,000) +		
3/12 x ₦1,500,000 profit		
= (₦360,000) + ₦375,000 profit	15,000	profit
1990 – 1/1/90 to 31/12/90		
9/12 x 1,500,000 + 3/12 x ₦2,750,000		
= ₦1,125,000 + ₦687,500	1,812,500	profit

Notes:

(a) Taking the two years together will give total Assessable profits of ₦1,827,500. Based on election as against NIL Assessable profit without election. It is not to the taxpayer's advantage to elect.

(b) Cocoa processing will fall into the business of manufacturing, hence no restriction of capital allowances.

2. JAYNE NIGERIA LIMITED
INCOME TAX COMPUTATIONS FOR 1997, 1998 AND 1999 ASSESSMENT YEARS

	₦	₦
Net Profit for the year ended 31 May 1998		1,540,000
Add: Depreciation		132,145
Adjusted Profit for the year		1,672,145
1997 ASSESSMENT YEAR		
Actual for the 7 months ($^7/_{12}$ x ₦1,672,145)		975,418
Deduct: Capital allowances		
Investment allowance	142,500	
Initial Allowance	1,759,000	
Annual Allowance	334,382	(2,235,882)
Un-recouped capital allowance c/f		(1,260,464)
Total Profit		Nil

	₦	₦
Income tax liability at 30%		Nil
Tertiary Education Tax at (2% of ₦975,418)		₦19,508

1998 ASSESSMENT YEAR

First 12 months of operation ($^{12}/_{12}$ x ₦1,672,145)		1,672,145
Deduct: Capital Allowances		
B/f from 1997 Assessment year	1,260,464	
For the year	573,225	(1,833,689)
Unrecouped Capital Allowances c/f		(161,544)
Total Profit		Nil
Income Tax Liability at 30%		Nil
Education Tax (at 2% of ₦1,672,145)		33,443

1999 Assessment year

Preceding Year basis ($^{12}/_{12}$ X ₦1,672,145)		1,672,145
Deduct: Capital Allowances		
B/F from 1998 assessment year	161,544	
For the year	573,225	734,769
Total Profits		937,376
Income tax liability (at 30% of ₦937,376)		281,213
Education Tax (at 2% of ₦1,672,145)		33,443

Workings
JAYNE NIGERIA LIMITED
CAPITAL ALLOWANCE COMPUTATIONS

	Motor Vehicle	Plant & Machinery	Industrial Building	Non-Industrial Building	Total
Allowances Rates:					
Investment		10%			
Initial	50%	50%	15%	15%	
Annual	25%	25%	10%	10%	
1997 Assessment Year					
(7 Months)	N	N	N	N	N
Cost	1,250,000	1,425,000	1,890,000	920,000	5,485,000
Investment allowance	142,500				142,500
Initial Allowance	(625,000)	(712,500)	(283,500)	(138,000)	(1,759,000)

	₦	₦	₦	₦	₦
Balance after In all (A)	625,000	712,500	1,606,500	782,000	3,726,000
Annual all Full Year	156,250	178,125	160,650	78,200	
A. A. claim for 7/12 (B)	(91,146)	(103,906)	(93,713)	(45,617)	(334,382)
WDV c/f to 1998 (A-B)	533,854	608,594	1,512,787	736,383	3,391,618
1998 Assessment Year					
Deduct Annual Allowance	(156,250)	(178,125)	(160,650)	(78,200)	(573,225)
WDV c/f to 1999	377,604	430,469	1,352,137	658,183	2,818,393
1999 Assessment Year					
Deduct Annual Allowance	(156,250)	(178,125)	(160,650)	(78,200)	(573,225)
WDV c/f to 2000	221,354	252,344	1,191,487	579,983	2,245,168

Note: Investment allowance at 10% is due on qualifying expenditure on plant and machinery.

3. (a) Prior to the expiration of its tax relief period, a pioneer company shall not carry on any trade or business other than a trade or business, the whole of the profit of which are derived from its pioneer operations. Where, prior to the expiration of its tax relief period, any profit earned by the pioneer company from any of its operations and activities whatsoever other than from its pioneer business, shall be deemed for the purposes of the Act, to be derived in Nigeria and shall be liable to tax.

(b) During its tax relief period, a pioneer company shall not:

(i) Make any distribution to its shareholders by way of dividends or bonus in excess of the amount by which the account to be kept by the company is in credit at the date of any such distribution.

(ii) Grant any loan without first obtaining the consent of the Minister, which shall only be given if he is satisfied that the pioneer company is obtaining adequate security and a reasonable rate of interest for any such loan.

(iii) For the purpose of the trade of a company which operates a plantation and to which a Pioneer certificate has been granted, shall be deemed to

have "Commenced" on the date when planting first reaches maturity, and any expenditure incurred on the maintenance of a planted area up to that date, shall be deemed to have brought unto existence an asset, and the expenditure shall be qualifying plantation expenditure for the purpose of the Act.

(iv) The accounting period shall be:

- A period not exceeding one year, commencing on its production day
- A successive period of one year thereafter
- A period not exceeding one year ending at a date when its tax relief period ends.

4. DEELBEST WORKS LIMITED
Computation of Income Tax Liabilities for 2006 to 2008 (Pioneer Period)

	2006	2007	2008
	N'000	N'000	N'000
Adjusted Profit/(Loss) (W1)	(600)	10,180	6,300
Tax Liabilities	NIL	NIL	NIL

DEELBEST WORKS LIMITED
Computation of Income Tax Liabilities for 2009 (New Business)

	N'000	N'000
Adjusted Profit		6,790
Less Capital Allowances		
Initial	424	
Annual	205	629
Total Profit		6,160
Income Tax @ 30%		**1,848**

(W1) **DEELBEST WORKS LIMITED**
Computation of Adjusted Profit/(Loss) for 2006 to 2008 Years of Assessment

	2006	2007	2008	2009
	N'000	N'000	N'000	N'000
Net Profit/(Loss)	(1,500)	11,700	9,800	5,090
Add back /(Deduct)				
Depreciation	900	1,880	1,500	1,700
Profit on Sale of Assets	-	(3,400)	(5,000)	-
Adjusted Profit/(Loss)	**(600)**	**10,180**	**6,300**	**6,790**

CHAPTER 10

Transfer Pricing

Contents

1. Purpose
2. Introduction
3. Significance of Transfer Pricing
4. Legal Framework for Transfer Pricing
5. Arm's Length Principle
6. Transfer Pricing and Multinational Companies
7. Transfer Pricing Methods and Evaluation of Taxpayer's Controlled Transactions
8. Documentation
9. Key Definition and Other Issues to be Considered in Transfer Pricing
10. Arm's Length Comparability Factors in Transfer Pricing
11. Administration of Transfer Pricing Regulation
12. Chapter Review
13. Worked Examples

10

TRANSFER PRICING

10.0 PURPOSE

After studying this chapter, readers should be able to:

(a) identify the laws regulating transfer pricing in Nigeria;
(b) apply the various laws on the assessment of companies;
(c) identify related parties and transactions and their effects on Total profits and assessments;
(d) identify and treat appropriately transferred goods and services between Multinational companies;
(e) describe some transfer pricing guidelines and methods by OECD;
(f) understand the transfer pricing documentation process;
(g) know the differences between Transfer Pricing Policy and Transfer Pricing Compliance document;
(h) know the contents and timing of transfer pricing report prescribed by the Federal Inland Revenue Service.

10.1 INTRODUCTION

Transfer Pricing is not new in Nigeria, but the laws regulating it were put together in 2012. The 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 can be referred to as a transfer price. It is also referred to as the price at which an enterprise transfer physical goods and intangible property or provides services to associated enterprises. With particular reference to multinationals companies, transfer pricing is a mechanism used by the multinationals to transfer goods and services between their related or associated companies worldwide. 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).

From the foregoing, Transfer Pricing 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).

10.2 SIGNIFICANCE OF TRANSFER PRICING

Transfer Prices at which goods and services are transferred between entities are significant for both taxpayers and tax authorities. This is so because they impact on the income and expenses as well as taxable profits of related companies in different tax jurisdictions in which the enterprise 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 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 market 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 group company.

10.3 LEGAL FRAMEWORK FOR TRANSFER PRICING

Transfer Pricing in Nigeria is regulated by the existing tax laws which are as follows:

(a) Section 22 of the Companies Income Tax Act CAP C21 LFN 2004 (as amended)
(b) Section 17 of the Personal Income Tax (amendment) Act 2011
(c) Section 15 of the Petroleum Profits Tax Act CAP P13 LFN 2004 (as amended)
(d) Section 61 of the Federal Inland Revenue (Establishment) Act 2007; and
(e) 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 Regulations), 2012.

10.3.1 Highlight of the Income Tax (Transfer Pricing) Regulation Act of 2012

Income Tax Transfer Pricing Regulation Act of 2012 was signed into law in August 2012 and gazetted in September 2012. It's 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.

10.3.2 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.

(c) Scope

(i) The regulations shall apply to transactions between connected taxable persons carried on in a manner not consistent with the arm's length principle and includes:-

- 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.

(ii) 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.

10.4 ARM'S LENGTH PRINCIPLE

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 these 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.

(b) Where a connected taxable person fails to comply with the provisions of this 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".

10.5 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 centers 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, TotalfinaElf, Chevron Texaco, Agip, Shell Petroleum Development Company, etc. Other sectors of the Nigerian economy 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 subject to the tax authorities of many different countries.

10.5.1 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.

10.5.2 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 underprice inter-group transactions depending on what they want to achieve.

10.5.3 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.

10.5.4 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.

10.5.5 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.

10.6 TRANSFER PRICING METHODS AND EVALUATION OF TAXPAYER'S CONTROLLED TRANSACTIONS

It may however be difficult to determine and fix appropriate market prices which will reflect arm's length transactions due to inavailability of similar product or services to be compared in the open market.

The Nigerian tax legislations have not dealt specifically with the subject of transfer pricing, 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 (CUP) 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 Revenue 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 this regulation, 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.

10.6.1 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. For example, X Ltd and Y Ltd are members of the same group. If X Ltd sells a particular product to independent parties as well as to Y Ltd

under similar circumstances, the prices charged for X Ltd's sales to independent parties can be compared with prices charged for X Ltd's sales to Y Ltd **(internal comparable).**

Similarly, if an independent party (M Ltd) sells to another independent party (N Ltd) the same product sold by X Ltd, the prices charged by M 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 X Ltd and Y 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 a reasonable comparability adjustments for such differences.

10.6.2 Resale Price Method (RPM)

The resale price method begins with the resale price to an independent enterprise of a product purchased from an associated enterprise and a gross margin is then deducted from this resale price.

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.

10.6.3 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).

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.

10.6.4 Profit Split Method (PSM)

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.

10.6.5 Transactional Net Margin Method (TNMM)

Under this method, the net profit margin that an enterprise earns from transactions with an associated enterprise is compared with the net profit margin earned in comparable transactions with an independent enterprise.

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.

10.7 DOCUMENTATION

Transfer Pricing documentation will include:

(a) Transfer Pricing Policy
(b) Transfer Pricing Compliance Report
(c) Transfer Pricing Returns i.e. TP declaration and disclosure forms.

10.7.1 Transfer Pricing Policy

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:

(a) Group Transfer Pricing Policy
(b) Local Transfer Pricing Policy.

Features of a 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.

10.7.2 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.

10.8 KEY DEFINITION AND OTHER ISSUES TO BE CONSIDERED IN TRANSFER PRICING

10.8.1 Controlled Transaction

Controlled Transaction constitute commercial or financial transaction between connected taxable persons.

10.8.2 Connected Taxable Persons

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 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.

10.9 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.

10.10 ADMINISTRATION OF TRANSFER PRICING REGULATION

The following areas are to be noted and complied with by the taxpayers and tax practitioners in Nigeria.

(a) **Annual Transfer Pricing Returns:** A connected taxable person must submit TP document annually to FIRS. Transfer Pricing disclosure and declaration forms are to be attached to the annual tax returns.

(b) **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.

(c) **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.

(d) **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.

10.11 CHAPTER REVIEW

This chapter highlights the following:

(a) Transfer prices are significant for both taxpayers and tax administration because they impact on the income and expenses and, therefore, taxable profits of associated enterprises in different tax jurisdictions.

(b) OECD Transfer Pricing Guidelines distinguish between five transfer pricing methods, namely: Comparable Uncontrolled Price Method, Resale Price Method, Cost Plus Method, Profit Split Method and Transactional Net Margin method.

(c) When a company is financed with a much greater proportion of debt than equity it is said to be thinly capitalized. In financial accounting, it is said that the company is **highly geared**. The tax authority is disturbed because of the excessive interest deductions particularly if the loans are obtained from connected or related parties at non-commercial rates or from foreign entities. Interest deduction reduces the profits available for tax. To circumvent the negative effects of thin capitalization, some countries place a limit on the debt to equity ratio, while others disallow interest deductions above a certain level.

(d) Transfer pricing is not in itself illegal or abusive, what is illegal or abusive is transfer mispricing, manipulation or abusive transfer pricing. It is therefore a compliance obligation and its practices in inter-company transactions expect to meet arm's length principles.

10.12 WORKED EXAMPLES

10.12.1 Questions

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;

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.

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

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.

10.12.2 Suggested Solutions

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 underprice 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.

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
(x) Particulars of the person making the declaration.

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.

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.

CHAPTER 11

Double Taxation Arrangement

Contents

1. Purpose
2. Double Taxation Relief
3. Commonwealth Income Tax Relief
4. Impact of Double Taxation
5. Resolution of Conflicts between DTA's and Nigerian Tax Laws
6. Taxation of Business Profits, movable and immovable properties
7. Taxation of Investments Income
8. Chapter Review
9. Worked Examples

11

DOUBLE TAXATION ARRANGEMENT

11.0 PURPOSE

After studying this chapter, readers should be able to:

(a) understand the concept of double taxation relief.

(b) know the double taxation relief available to a company where there is no double taxation agreement.

(c) understand the double taxation relief available to a company where there is double taxation agreement. Identify the substance in a typical double taxation agreement between two countries using the agreement between Nigeria and United Kingdom as a model.

11.1 DOUBLE TAXATION RELIEF

11.1.1 Introduction

When a Nigerian company earns foreign income, such will be included in its chargeable profit for the year and subjected to Nigerian tax.

In most of the cases, the amount that would be received in Nigeria would eventually 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 company receiving the income is being penalised for earning foreign income. In order to minimise the tax impact on such income, it is only reasonable that some relief from Nigerian taxation is given to the company. Section 33 of CITA deals with circumstances where there are no specific double taxation agreements while Sections 34 and 35 cover cases where there are agreements.

The tax payable in the foreign country is referred to as Commonwealth Income Tax. This is defined in Section 33(3) of the Act as "...any tax on income or profits of companies charged under a law in force in any country within the Commonwealth or in the Republic of Ireland which provides for relief from tax charged both in that country and Nigeria in a manner corresponding to the relief granted by this Section". "This Section" implies Section 33.

11.1.2 Commonwealth Income Tax Relief

(Where there is no double taxation agreement)

Section 33(1) deals with the Nigerian Companies.

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 profit. The relief is used to reduce the tax paid or payable in Nigeria on the part of the company's profits which is liable to tax in Nigeria and in any country within the Commonwealth or in the Republic or 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 that year.

For example, if a company wishes to claim the relief in respect of profits earned in 2004 which were subjected to tax in 2005 year of assessment, the claim must be made on or before 31 December, 2011. If the claim is admitted, the amount of tax to be relieved will be replied out of the tax paid for that year of claim or set against the tax which the company is liable to pay for that year of claim.

The relief available to a Nigerian company from tax on its foreign income shall be:

(a) If the Commonwealth rate of tax does not exceed one - half of the Nigerian rate of tax, the Commonwealth rate of tax; and

(b) In any other case, half of the Nigerian rate.

In other words, the rate of relief to be given to a Nigerian company is either the Commonwealth rate or half of the Nigerian rate, whichever is lower. Therefore, for Commonwealth rates of say 20% and 50% against the Nigerian rate of 30%, the relief available against tax on foreign incomes received by a Nigerian company shall be the use of 15% and 15% tax rate respectively.

Section 33(2) covers Non-Nigerian Companies.

For a non-Nigerian company, the relief available shall be:

(a) If the Commonwealth rate of tax does not exceed the Nigerian rate of tax, one-half of the Commonwealth rate; and

(b) If the Commonwealth rate of tax exceeds the Nigerian rate, the amount by which the Nigerian rate exceeds one-half of the Commonwealth rate.

For example, the foreign income of a non-Nigerian company received in Nigeria has suffered commonwealth rate at 30% and that of another company at 50%. With the current Nigerian rate at 30% the rate of relief shall be:

(a) For the first company, 15% that is ½ of Commonwealth rate – the Commonwealth rate of 30% does not exceed the Nigerian rate of 30%.

(b) For the second company, 5% that is the difference between the Nigerian rate and ½ of the Commonwealth rate – the Commonwealth rate of 50% is higher than the Nigerian rate of 30%.

It is not certain how this provision of Section 33(2) will be applied to Non-Nigerian companies as such companies are liable to Nigerian tax only to the extent to which their income is derived from their operations in Nigeria. In other words, they are not liable to Nigerian tax on their foreign income.

Readers should note that the relief discussed above will be granted where there are reciprocal provisions in the tax laws of the country from where the income is being received.

11.1.3 Double Taxation Agreement

(Where there is Double Taxation Agreement)

The provision of the law states "where there exists double taxation agreement between one country and Nigeria, the amount of relief available will be computed on the basis of the provisions of the agreement and Sections 34 and 35 of the Act".

The points to note are:

(a) The provisions of Section 33 of the Act shall have no effect.

(b) "Foreign tax" means any tax payable in a country which under the agreement is to be allowed as a credit against tax payable in respect of those profits in Nigeria.

(c) The tax payable on the worldwide income will be reduced by the credit admissible under the terms of agreement.

(d) Credit is allowable only for a Nigerian company.

(e) The total credit to be allowed for the foreign tax for any year of assessment, cannot exceed the total tax payable by the company for that year. In effect, no cash refund can be made in Nigeria for foreign tax paid.

(f) A company can elect not to take the benefit of the credit available under the arrangement in respect of the foreign profit earned by it, for the assessment year.

(g) Any claim for an allowance by way of credit shall be made not later than two years after the end of the assessment year.

(h) In the event of any dispute as to the amount allowable, the claim shall be subject to objection and appeal in like manner as an assessment.

11.1.4 Double taxation agreement with United Kingdom

After the termination of all double taxation agreements between foreign countries and Nigeria, one of the earliest agreement that was signed is that with the United Kingdom.

The substance of the agreement is contained in the explanatory note to the schedule of the agreement. The following should be noted:

(a) Income from immovable property may be taxed in the country in which the property is situated (Article 6).

(b) Business profits not arising through a permanent establishment are to be taxed only in the country of the taxpayer's residence. Profits attributed to a permanent establishment may be taxed in the country in which the permanent establishment is situated (Article 7).

(c) Profits or gains arising from the operation of ships and aircraft in international traffic are to be taxed only in the country of residence of the operator (Article 8).

(d) Dividends derived by one company which is resident in one country from a company resident in another country may be taxed in that country in which the dividend is derived. However, the rate of tax in the source country is not to exceed 12.5% where the recipient is a company controlling at least 10 per cent of the voting power in the company paying the dividends, and 15 per cent in all other cases (Article 10).

(e) Interest arising in one country and paid to a resident of the other country may be taxed in that other country. The rate of tax in the source country is, in general, not to exceed 12.5 per cent. However, interest arising in one country and paid to the Government or any government agency of the other country is to be exempt in the country of source (Article 11).

(f) Royalties arising in one country and paid to a resident of the other country may be taxed in that other country. However, the rate of tax in the source country is not to exceed 12.5 per cent (Article 12).

(g) Except with the exemption of profits or gains arising from the operation of ships and aircraft in international traffic, each country may tax capital gains in accordance with the provisions of its domestic law (Article 13).

(h) Income derived by a resident of one country in respect of professional services or other independent activities of a similar character, shall be taxable only in that country, unless he has a

fixed base regularly available to him in the other country, for the purpose of performing his activities. In this case, so much of the income may be taxed in that other country as is attributable to that fixed base (Article 14).

(i) Directors' fees and other similar payments derived by a resident of a country, in his capacity as a member of the Revenue Service of directors of a company, which is a resident of the other country, may be taxed in that other country (Article 16).

(j) Income derived by artists and athletes may be taxed in the country where the activities are exercised (Article 17).

(k) Where income continues to be taxable in both countries, credit will be given by the country of the taxpayer's residence in respect of tax imposed by the other country (Article 22).

Foreign incomes exempted from Nigerian tax

With effect from 1 January, 1988 investment incomes, namely; dividends, interests, royalties and rents, derived by a company from outside Nigeria, is exempted from Nigerian tax, provided that such income is brought into Nigeria through Government approved channels. Government approved channels means the Central Bank of Nigeria, any bank or other corporate body appointed by the Minister as authorised dealers under the Second-Tier foreign Exchange Market Act or any enactment replacing that Act. In such situations, there would not have been any double taxation and therefore there would be no need to grant any relief in form of tax credit.

11.3 IMPACT OF DOUBLE TAXATION

(a) Avoidance of double taxation

(b) Clarification of taxing rights of each state

(c) Encouragement of Economic cooperation between states

(d) Prevention of physical evasion with anti-avoidance provision

(e) Lowering of compliance cost

11.4 RESOLUTION OF CONFLICTS BETWEEN DTA's AND NIGERIAN TAX LAWS

(a) Where a resident of a Contracting State considers that the action of one or both of the Contracting States result or will result from him in taxation not in accordance with this Agreement, with the competent of the contracting state of which of which he is resident.

(b) The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to and if it is not itself able to resolve the case by mutual agreement with the competent authority of

the other Contracting State, with a view to the avoidance of taxation not in accordance with the Agreement.

(c) The competent authorities of the Contracting State Shall endeavour to resolve by mutual agreement any difficulties or doubt arising as to the interpretation or application of the Agreement.

(d) The competent authorities of the Contracting State may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

Business Profits

(a) 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 profit of the enterprise may be taxed in the other State but only so much of them as is attributable that permanent establishment.

(b) Subject to provisions of paragraph (3) of this article 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 profit which it might be expected to make if it distinct and separate enterprise engaged in the same or activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

(c) In the determination of the profit of a permanent establishment there shall be allowed as deductions expenses shown to have been incurred for the purposes of the business 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. However, no such deductions shall be allowed in respect of amounts, if any, paid (otherwise wards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its offices by way of royalties, fees or other similar payment in return for use of or other rights, or by way of commission, for specific services performed or for management, or, except in the case of banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profit of a permanent establishment, for amount charged (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payment in

return for the use of patents or other rights, or by way of commission for specific services performed or for management or except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

(d) No profits shall be attributed to a permanent establishment by the reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise:

Provided that where that permanent establishment is also used as a sales outlet for the goods or merchandise so purchased the profit on such sales may be attributed to that permanent establishment.

(e) Where profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Article shall not be affected by the provisions of this Article.

11.5 ACTIVE DOUBLE TAXATION AGREEMENT

Tabular Presentation of List of Countries having DTA with Nigeria:

Countries	DTA Type	Date/Place of Signing	Date of Entry into Force	Effective Date
Canada	Comprehensive	4 August 1992 in Abuja	16 November 1999	1 January 2000
Pakistan	Comprehensive	10 October 1989 in Lagos	7 March 1990	1 January 1991
Belgium	Comprehensive	20 November1989 in Brussels	1 January 1990	1 January 1991
France	Comprehensive	27 February 1990 in Paris	2 May 1991	1 January, 1992
Romania	Comprehensive	21 July 1992 in Abuja	18 April 1993	1 January 1994
Nether-lands	Comprehensive in Lagos	11 December 1991	9 December 1992	1 January 1993
United Kingdom	Comprehensive	9 June 1987 in London	1 January 1988	1 January 1989
China	Comprehensive in Abuja	15 April 2005	21 March 2009	1 January 2010
South Africa	Comprehensive in Cape Town	29 April 2000	5 July 2008	1 January 2009
Italy	Air & Shipping Agreement Only	22 February 1976 in Lagos	1977	1 January 1978

Date of Entry into Force of the DTA

This is the date the Agreement is deemed to be a law forming part of the body of the legal system of both Contracting States. In essence, the Agreement becomes an enforceable law in both States because it has fulfilled necessary domestication procedures. This is provided for in Article 28 (1) of the various DTAs that;

"each of the Contracting States shall notify to the other the completion of the procedures required by its law for the bringing into force of this Agreement. The Agreement shall enter into force thirty days after the date of receipt of the latter of these notifications".

Effective date or date of application of the Agreement

Both of these clauses are often used interchangeably. However, it is the date citizens of both Contracting States start benefiting from the Agreement as provided for in Article 28 (2) (a) (i)(ii) of the various DTAs. Technically, the Effective Date of the Agreement is the first day of the fiscal year following the date of Entry into Force of the Agreement.

11.6 TAXATION OF BUSINESS PROFITS, IMMOVABLE AND MOVABLE PROPERTIES

(a) Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State .

(b) 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 landed property apply, usufruct of immovable property and right to variable or fixed payments as consideration for the working of or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as immovable property.

(c) The provisions of paragraphs (1) of this Article shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

(d) The provisions of paragraphs (l) and (3) of this Article shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

11.7 TAXATION OF INVESTMENTS INCOME

(a) Dividends

(i) Dividends derived from a company which is a resident of a Contracting State by a resident of the other Contracting State may be taxed in that other State.

(ii) However, such dividends may also be taxed in the Contracting State of which the company paying the dividend is a resident according to the law of that State, but where the recipient of the dividend is subject to tax thereon in the other Contracting State the tax so charged shall not exceed:

- 12½ per cent of the gross amount of the dividend if the recipient is a company which controls directly or indirectly at least ten percent of the voting power in the company paying the dividend;
- Fifteen per cent of the gross amount of the dividend in all other cases.

(iii) The term "dividends" as used in this Article means income from shares, or any other item (other than interest relieved from tax under the provisions of Article 11 of this Agreement) which, Under the law of the Contracting State of which the company paying the dividend is a resident, is treated as a dividend or distribution a Company.

(iv) The provisions of paragraphs (1) and (2) of the Article shall not apply where the beneficial owner of the dividends, being a resident of one of the Contracting State, has in the other Contracting State a permanent establishment, or performs in that other State independent personal services from a fixed base situated therein, and the holding by virtue of which the dividends are paid is effectively connected with the business carried on through such permanent establishment or fixed base. In such a case the provisions of Article 7 or 14, as the case may be shall apply.

(v) Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other state may not impose any tax on the dividends paid by the company and beneficially owned by persons who are not residents of the other state, or subject to the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in that other State.

(vi) The provisions of this Article shall not apply if the right giving rise to the dividends was created or assigned mainly for the purpose of taking advantage of this Article and not for bona fide commercial reasons.

(b) Interest

(i) Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

(ii) However, such interest may also be taxed in the Contracting State in which it arises, and according to the law of that State, but where such interest is paid to a resident of the other Contracting State who is subject to tax there in respect thereof the tax so charged shall not exceed 12 per cent of the gross amount of the interest.

(iii) Notwithstanding the provisions of paragraph (2) of this article , interest arising in a Contracting State shall be exempt from tax in that State if it is derived and beneficially owned by the Government of the other Contracting State or a local authority.

(iv) The provisions of paragraphs (1) and (2) of this Article shall not apply if the beneficial owner of the interest, being a resident of contracting State, has in the other Contracting State in which the interest arises a permanent establishment situated therein, or perform in that other State independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest paid is effectively connected with that permanent establishment or fixed base. In such a case the provisions of Article 7 or Article 14 as the case may be, shall apply.

(v) Interest shall be deemed to arise in a Contracting State when the payer is that State itself a political sub-division, a local authority or 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 Contracting State permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, then such interest shall be deemed to arise in the state in which the permanent establishment or fixed base is situated

(vi) 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 paid exceeds, for whatever reason the amount which would have been agreed upon by the

payer and the beneficial owner in the absence of such relationship, the provision 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 Agreement.

(vii) The term "interest" as used in this Article means income from 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 bonds or debentures.

(viii) The provisions of this Article shall not apply if the debt-claim giving rise to the interest was created mainly for the purpose of taking of this Article and not for bona-fide commercial reasons.

11.8 CHAPTER REVIEW

This chapter discusses the concept of double taxation relief, especially where there is no double taxation agreement among countries and where there is a double taxation agreement in place.

11.9 WORKED EXAMPLES

11.9.1 Questions

1. (a) Explain the concept of Double Taxation Relief
   (b) State the objectives of Double Taxation with another country
   (c) State the incomes exempted from Double Taxation.

2. What are the essential features of a Double Taxation Relief Agreement?

3. With respect to Double Taxation Arrangement, state precisely the provisions in respect of the following:
   (a) Business Profits not arising through a permanent establishment
   (b) Profits or gains arising from the operation of ships and aircrafts
   (c) Interest arising in one country and paid to a resident of the other country
   (d) Dividends derived by one company which is resident in one country form a company resident in another country
   (e) Director's fees and other similar payments derived by a resident of a country in his capacity as a director of a company which is a resident of the other country

4. AD International Limited runs a pharmacy practice in Nigeria and Ghana. The company's operating results for the year ended 31 December 2002 are as follows:

	₦
Income from Nigeria	50,000,000
Income from Ghana	22,000,000
Total Income	**72,000,000**
Less: Overheads	(40,000,000)
NET PROFIT	32,000,000

Included in the Overheads were:

(a)	Depreciation – Nigeria business	-	4,500,000
(b)	Depreciation – Ghana business	-	750,000
(c)	Donations to clubs in Nigeria	-	250,000
(d)	Foreign tax suffered	-	4,200,000
(e)	Profit attributable to Ghana business	-	5,150,000

Capital allowances agreed with tax officials for Nigeria and Ghana businesses were ₦3,540,000 and ₦1,450,000, respectively.
Assume the company is a wholly owned Nigerian company.

Required:

Compute the tax liabilities on the Total income, stating clearly the double taxation relief applicable to the company.

11.9.2 Suggested Solutions

1(a) Double Taxation Relief is a bilateral agreement between two countries with the aim of exempting certain classes of incomes already subjected to tax in another country from further tax in the hands of the recipient.

(b) The objectives of Double Taxation with another country are:

(i) Avoidance of benefit
(ii) Lowering of compliance cost
(iii) Prevention of fiscal evasion and avoidance
(iv) Co-operation in tax matters
(v) Certainty of tax treatment

(c) Types of incomes exempted from Double Taxation

(i) The remuneration of a Professor or a Teacher who is resident for not more than two years in the other country for the purpose of teaching.

(ii) Government pensions except the recipient is ordinarily resident in Nigeria.

(iii) Aircrafts and shipping profits.

(iv) Dividends paid by the other contracting states to a Nigerian resident who has no permanent establishment

(v) Payments to a student or apprentice during his full time education or training in Nigeria.

(vi) The income of a resident in the contracting state provided.

2. Features of a Double Taxation Relief Agreement: The following are some of the key features of a Double Taxation Relief Agreement:

(a) The names of the two countries involved in the agreements would be stated together with the definition of residence and person affected

(b) The rates of tax applicable in the countries would be stated with a caveat that the rates may be changed without notice

(c) The transactions on which double taxation relied is applicable. This will usually include business profit, fees, capital gains tax etc.

(d) The arrangement for the exchange of information between the two tax authorities so as to minimize the incidences of tax evasion

(e) The appeal procedures in the event of a dispute

(f) The available diplomatic privileges for the taxpayers

(g) The date of coming into force of the agreement and the possible termination date

(h) Connected businesses including enterprises in the two countries under common control or where one has control over the other

(i) The distinction in industrial and commercial profits especially for enterprises engaged in business partly in Nigeria and partly in other countries

(j) The profits exempted from tax

(k) The methods by which the effect of Double taxation is eliminated

3. (a) Business profits not arising through a permanent establishment are to be taxed only in the country of the taxpayer's residence. Profits attributed

to a permanent establishment may be taxed in the county in which the permanent establishment is situated (Article 7).

(b) Profits or gains arising from the operation of ships and aircraft in international traffic are to be taxed only in the country of residence of the operator (Article8).

(c) Interest arising in one country and paid to a resident of the other country may be taxed in that other country. The rate of tax in the source country is, in general, not to exceed 12.5 per cent. However, interest arising in one country and paid to the Government or any government agency of the other country is to be exempt in the country of source (Article 11).

(d) Dividends derived by one company which is resident in one country may be taxed in that country in which the dividend is derived. However, the rate of tax in the source country is not to exceed 12.5% where the recipient is a company controlling at least 10 per cent in all other cases (Article 10).

(e) Directors' fees and other similar payments derived by a resident of a country, in his capacity as a director of a company which is a resident of the other country, may be taxed in that other country (Article 16)

4. AD INTERNATIONAL LIMITED
2003 INCOME TAX COMPUTATIONS
BASIS PERIOD: 01/01/02 – 31/12/02

	₦	₦
Net Profit Per Accounts		32,000,000
Add:		
Depreciation – Nigeria	4,500,000	
Depreciation – Ghana	750,000	
Donations to clubs – Nigeria	250,000	
Foreign tax suffered	4,200,000	9,700,000
Assessable Profit		41,700,000
Deduct:		
Capital Allowance – Nigeria	3,540,000	
Capital Allowance – Ghana	1,450,000	
(Maximum of $66^2/_3$% of ₦41,700,000)		(4,990,000)
TOTAL PROFIT		**36,710,000**
Income tax at 30%		11,013,000
Less: Double Taxation Relief (15% of ₦8,650,000)		(1,297,500)
Final Tax Liability		**9,715,500**
Education Tax - 2% of Assessable Profit of ₦41,700,000		834,000

COMPUTATION OF TOTAL PROFIT FOR GHANA BUSINESS

	₦	₦
Net profit per Ghana Accounts		5,150,000
Add:		
Depreciation	750,000	
Foreign tax	4,200,000	4,950,000
Assessable Profit		10,100,000
Less: Capital Allowances		(1,450,000)
TOTAL PROFIT		8,650,000

Commonwealth Rate of Tax $= \frac{4,200,000}{8,650,000} \times 100\% =$ 48.55%

Nigeria income tax rate 30%

Note:
Since the Commonwealth rate of tax exceeds one half of Nigerian rate, half of Nigerian rate is applicable for double taxation relief.

Professional level

Advanced Taxation

CHAPTER 12

Mergers and Acquisitions

Contents

1. Purpose
2. Introduction
3. Mergers, Acquisitions and Takeovers
4. The Main Highlights
5. Chapter Review
6. Worked Examples

12

MERGERS AND ACQUISITIONS

12.0 PURPOSE

After studying this chapter, readers should be able to:

(a) understand the concept of mergers, acquisitions and takeover;
(a) know the implications of a new company taking over an existing one;
(b) understand the tax implications of an existing company absorbing another;
(c) know the tax implications of trade, business sold or transferred; and
(d) understand the tax implications of reconstituted companies.

12.1 INTRODUCTION

Mergers and Acquisitions

A merger is an arrangement in which the assets, liabilities and businesses of two or more companies are vested in and carried on by one company, which may or may not be one of the merging companies and under a situation in which the new company is owned by the owners of the merging companies.

(a) **Horizontal Merger**

This involves a merger involving companies in the same line of business (producing similar goods or providing similar services) e.g merger of two banks (former Chartered Bank and IBTC, merged to become IBTC Chartered Bank Plc.

(b) **Vertical Merger**

A merger between two businesses in the same industry where one company supplies goods to the other company. An example is a soft drink company merging with a bottle making company.

(c) **Acquisition**

Acquisition is said to involve the purchase of all or majority of the equity shares of one or more companies by another company:

Where A limited acquires more than 50% of the equity shares of companies B & C, these B & C become the subsidiaries of A, and while A becomes the holding company.

12.2 MERGERS, ACQUISITIONS AND TAKEOVERS

12.2.1 Mergers

The tax implications of amalgamation, absorption and takeovers, depend on the particular type of arrangement effected by the companies and the result of such arrangement. The common possibilities are as follows:

New Company Takes Over

Where a new company takes over an existing company, the trade or business of the existing company ceases. Thus, cessation provisions will apply to that company that has been taken over.

The new company commences a new business. Commencement provisions of the law will apply to the new company.

An existing company absorbs another

Where an existing company acquires or absorbs another company, the operation of the company acquired or absorbed ceases. Therefore, the cessation provisions of the Act will be applied to that company.

In case of the company that takes over, consideration will be given to the nature of the company's trade or business both before and after the takeover.

If the trade or business carried on by the company is the same before and after the takeover, the company cannot be said to have commenced a new trade or business. This will be the case if the trade or business of the company that is taken over is essentially the same as the trade or business of the company that acquires it. In such circumstance, commencement provisions will not be applied.

However, if the trade or business of the absorbed company is different from that of the company that acquires it, the company acquiring will be deemed to have commenced a new trade or business. In such a situation, the commencement provisions of the Act will apply to the new trade or business while the existing business of the company will be assessed on a continuing trade basis.

Mergers and Take-over

The consent of the Revenue Service, including clearance with respect to any Capital Gains Tax that may be due and payable, must be obtained before any merger, take-over, transfer or restructuring of a trade or business carried on by a company can take place.

12.2.2 Trade or Business Sold or Transferred: Section 29(9)

If a trade or business is sold or transferred to a Nigerian company together with any asset employed therein and the Revenue Service 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 recognised group of companies, the Revenue Service may at its discretion direct that:

(a) The commencement and cessation provisions are not applied;

(b) 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

(c) 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 unutilised losses incurred in the old trade. Such losses cannot be transferred to the new business and may not be relieved in any other way. Any company planning a reorganisation 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.

12.2.3 Reconstituted Companies: Section 29 (10)

Where in pursuance of Part X of the Companies and Allied Matters Act, (2004), 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:

(a) The commencement and cessation provisions shall not apply to the reconstituted company;

(b) 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;

(d) 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 any 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 Revenue Service within three years of the incorporation of the reconstituted company; and

(e) 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 Revenue Service 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.

12.3 THE MAIN HIGHLIGHTS

(a) Emergence of a new company

(i) Rendition of annual returns
(ii) Commencement rule under Section 29(3) applies
(iii) Claim of allowances
(iv) Unabsorbed losses and un-utilized capital allowances brought forward
(v) Taxes and related expenses
- Stamp Duties
- Fees for SEC, NSE, CBN, land authorities, professional fees etc to be capitalized
- VAT-TAX at source on professional fees

(vi) Revision Scheme to be approved by Joint Tax Board

(b) **Where one of the merging companies survives with its old name or a new name**
   - (i) Surviving company must file returns not more than six months after the end of its accounting year
   - (ii) Commencement rule will not be applicable
   - (iii) No investment allowance on assets transferred
   - (iv) No initial allowance on assets transferred
   - (v) Claim of annual allowance on tax written down value (TWDV) of the assets inherited
   - (vi) Not to inherit the unabsorbed losses and unutilized capital allowance of the merger except there is evidence the company is reconstituted
   - (vii) Fees to be liable to VAT and WHT
   - (viii) Stamp duties to be paid on increase in Share Capital
   - (ix) Staff Pension Scheme to be approved by JTB

(c) **Where cessation of business occurs for any of the merging parties**
   - (i) Cessation rule as applicable under Section 29(4) of CITA
   - (ii) Cessation may not be applicable where the merging companies are connected in line with the service discretionary powers under Section 29(9) of CITA
   - (iii) Cessation may not be applicable where a reconstituted company is formed to take over the trade or business formerly run by its foreign parent company.

(d) **Capital Gains Tax**
Where Shareholders are either wholly or partly paid in cash for surrendering their shares in the ceased business, the gains arising from such payment will be subject to CGT, contrary to the provision of Section 3A of CGTA Act Cap C 1 LFN 2004).

12.4 CHAPTER REVIEW

This chapter discusses the tax implications of mergers, acquisitions and takeovers. It was noted that the consent of the Federal Inland Revenue Service must be obtained before any merger, take-over, transfer or restructuring of a trade or business carried on by a company, can take place.

12.5 WORKED EXAMPLES

12.5.1 Questions

1. (a) Explain the terms: Mergers, Acquisitions and Mergers
   (b) Briefly explain the tax implications of a company, merging with another company, where one of them inherits all the assets and operations of the merging companies.

2. Briefly explain the tax implications of:
   (a) Cessation of business for one of the merging parties.
   (b) Cessation of business where a reconstituted company is formed to take over the trade or business formerly run by its foreign parent company.

3. What are the tax implications of selling or transferring a company to another company where both companies belong to the same holding company?

4. Explain the tax implications of the following:
   (a) Two or more companies enter into a joint venture agreement or partnership.
   (b) Where shareholders are wholly or partly paid in cash for surrendering their shares in a ceased business.

12.5.2 Suggested Solutions

1(a) Mergers and Acquisitions

A merger is an arrangement in which the assets, liabilities and businesses of two or more companies are vested in and carried on by one company, which may or may not be one of the merging companies and under a situation in which the new company is owned by the owner of the merging companies.

Acquisition is the act of acquiring effective control over assets or management of a company by another company by acquiring substantial shares or voting rights of the target company.

(b)
- (i) The surviving company must file returns not more than six months after the end of its accounting year in accordance with Section 55(3)(a)
- (ii) Commencement rule will not be applicable
- (iii) No initial allowance on assets transferred
- (iv) Claim of annual allowance on tax written down values of the assets transferred
- (v) The company cannot inherit the unabsorbed losses and unutilized capital allowances of the merger unless there is evidence that the company is reconstituted
- (vi) All fees paid will be liable to VAT and WHT
- (vii) Stamp duties will be paid on increase in share capital
- (viii) Staff Pension Scheme to be approved by JTB.

2. (a) Cessation rules will be applicable in accordance with provision of Section 29(4) of CITA

   However, the cessation rule will not applicable where the merging companies are connected. This is a discretionary power of the Federal Inland Revenue Service in accordance with the provision of Section 29(9) of CITA

   (b) A re-constituted company is one registered in Nigeria to take over the assets of a foreign company in Nigeria. For a reconstituted company,

   (i) There will be no application of either the commencement or cessation rules.

   (ii) All the qualifying capital expenditure transferred are deemed to have been made at their tax written down values. The balancing adjustment may be computed.

   (iii) In the computation of capital allowance, no initial allowance may be computed while the annual allowance would be based on the unexpired tax life of the qualifying capital expenditure.

   (iv) Any unutilized capital allowances transferred are deemed to have been transferred prior to sale.

   (v) 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 reconstitution and the three subsequent tax years.

3. 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 Revenue is of the opinion that both companies belong to the same holding 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 tax written down values. The balancing adjustment may be computed.

   (c) In the computation of capital allowance, no initial allowance may be computed while the annual allowance would be based on the unexpired tax life of the qualifying capital expenditure.

   (d) Any unutilized capital allowances transferred are deemed to have been transferred prior to sale.

(e) Any unrelieved losses transferred are also deemed to have been relieved prior to the transfer or sale

4. (a) Where two or more companies enter into a joint venture agreement or partnership, then:

(i) The joint venture partnership is not chargeable to tax itself.

(ii) The profit chargeable to tax in the hand of each of the partners is the share of profit from the partnership.

(iii) Capital allowances on the assets of the partnership shall be shared in the agreed profit and loss sharing ratio.

(iv) Where any of the companies involved in the partnership has another line of business, the loss generated from the business will not be available for relief against the profit generated from the partnership.

(b) Where shareholders are either wholly or partly paid in cash for surrendering their shares in a ceased company, the gains arising from such payment will be subject to Capital Gains Tax. This is contrary to the provision of Section 3A of Capital Gains Tax Cap C I LFN 2004.

CHAPTER 13

Taxation of Special Businesses

Contents

1. Purpose
2. Introduction
3. Tax Distortion Under Inflationary Conditions
4. Special Businesses
5. Chapter Review
6. Worked Examples

13

TAXATION OF SPECIAL BUSINESSES

13.0 PURPOSE

After studying this chapter, readers should be able to:

(a) identify the provisions of Companies Income Tax Act CAP C21 LFN 2004 (as amended) applicable to companies engaged in shipping, air transport, business of transmission of messages and insurance businesses;

(b) prepare tax computations in respect of the special businesses in accordance with the relevant provisions of CITA; and

(c) distinguish the options available to the special businesses to enable them minimise their tax liabilities.

13.1 INTRODUCTION

CITA contains special provisions with regards to companies engaged in shipping or air transport business as well as those in insurance business. The provisions which are considered below are additional to the normal rules of allowable and disallowable expenditure in taxation practice.

13.2 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 proceeds over costs when an item is disposed of, 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 today (2009), 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 (if 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.

13.3 SPECIAL BUSINESSES

13.3.1 Introduction

CITA contains special provisions with regards to companies engaged in shipping or air transport business as well as those in insurance business. The provisions which are considered below are additional to the normal rules of allowable and disallowable expenditure in taxation practice.

13.3.2 Shipping or air transport / courier companies

Non-Nigerian Companies

CITA Section 14 contains provisions regarding companies, other than Nigerian companies, in shipping or air transport business.

The substance of that Section is as follows:

(a) The profits or losses of such company to be deemed to be derived from Nigeria is the full profits or losses arising from the carriage of passengers, mails, livestock or goods shipped, or loaded into an aircraft, in Nigeria. This does not apply to passengers, mails, livestock or goods which are brought into Nigeria solely for transshipment or for transfer from one aircraft to another or in either direction between an aircraft and a ship. Readers are referred to the part of this study pack on Double Taxation relief for such of these businesses that are exempted from Nigerian tax.

To the sums receivable in respect of passengers, etc. carried in Nigeria as referred to above, there shall be applied the following:

(i) The ratio of profits or losses of an accounting period, before depreciation, to the total sums receivable in respect of the business of the company, and

(ii) The ratio of depreciation to the total sums so receivable as certified by the tax authority of any other country (where the Non-Nigerian company is registered) to the satisfaction of the Revenue Service.

The amount arrived at shall be the full profits or losses which shall be liable to Nigerian tax.

Note that this situation will apply where the Revenue satisfied that the tax authority of any other country computes and assesses on a basis not materially different from that prescribed by the Act. The profits of a company which operates ships or aircrafts shall be certified to the revenue board by the taxation authority:

(a) Where the ratios referred to above cannot, for any reason, be satisfactorily applied, the profits to be deemed to be derived from Nigeria may be computed on a fair percentage on the full sum receivable in respect of the carriage of passenger, etc. shipped or loaded in Nigeria. When this occurs, the company has within six years to claim that its liability be recomputed on the basis of the ratios referred to above; and

(b) If the company fails to agree with the Revenue Service, the Revenue Service shall give notice to the company of refusal to admit the claim and the provisions of CITA with respect to objections and appeals shall apply accordingly with any necessary modifications.

From the 1988 assessment year, sub-section (4) was added to Section 12 to the effect that the tax payable for any year of assessment shall not be less than 2% of the full sums receivable in respect of the carriage of passengers, mails, livestock or goods shipped or loaded into an aircraft in Nigeria.

13.3.3 TAXATION OF INSURANCE COMPANIES

(a) INTRODUCTION

The taxation of insurance business is covered by Sec 14 of CITA 2007 The section deals with both Nigerian and Non-Nigerian insurance businesses. It further distinguishes between Life assurance business and Non-life insurance business.

For tax purposes, the main difference between the taxation of Life assurance business and Non-life business is that for Life assurance business, the premium received from the assured does not from part

of income for tax purposes since the assured will definitely be paid or indemnified either at his death or the attainment of a specified age under endowment policy. Since the premium is not taken as income, claims paid is also not allowable as a deduction for life assurance business, the reverse is applicable for Non-life insurance business.

With effect from 1995, where a company engages in composite insurance business, that is, a company carrying on both Life and Non-life insurance business, the income from each source would be taxed separately. This means that where a loss is incurred from life business, it cannot be relieved against income from non-life.

Like any other company, dividend received by insurance companies is treated as Franked investment income and they are exempted from tax.

The investment income does not include premium received from the assured. It is made up of dividend(to be exempted), interest, annuities, commission received, rent as well as surplus arising from actuarial revaluation of the reserve for the unexpired risk account or life fund account transfer to the profit and loss account for distribution.

(b) DETERMINATION OF ASSESSABLE PROFIT AND TAX LIABILITY LIFE BUSINESS

(i) **Nigerian Company:** The Assessable profit and tax liability of a Nigerian company carrying on life insurance business is determined as follows:

	₦	₦	₦
Investment income		xx	
Other Income		xx	
Actuarial Revaluation Surplus distributed		xx	
Gross Income		xx	
Deduct:			
i. General Reserves	xx		
Add Life Fund A/c	xx		
	xx		
Less Net liabilities on policies	(x)	x	
ii. Special Reserve			
The higher of:			
1 % of Gross premium		x	

	₦	₦	₦
10% of Net Profit	x	x	
iii. Other allowable Management expenses		x	(x)
Assessable profit			**xx**
Less Capital Allowance			(x)
Total profit			x

Tax payable shall be the higher of:

Tax paid as per Total Profit Computed; and
Tax paid on 20% of Gross income

Note:
Annual transfer to special reserves would depend on whether the total reserves is equal to or higher than the minimum statutory paid up capital.

(ii) **Non-Nigerian Company**: The assessable profit of a non-Nigerian company carrying on life assurance business is determined as follows:

	₦	₦
Investment Income (see working1)		x
Less Agency commission in Nigeria	x	
Allowable expenses in Nigeria	x	
Fair proportion of Head Office expenses	x	(x)
Assessable Profit		x

Working
Investment Income:

$$\frac{\text{Premium Receivable Nigeria}}{\text{Global Premium of the company}} \times \frac{\text{Global Investment Income}}{1}$$

(c) **NON-LIFE INSURANCE BUSINESS**

(i) **Nigerian Company:** The assessable profit and tax liability of a Nigeria company carrying on non-life insurance business is determined as follows:

	₦	₦	₦
Gross Premium			xx
Less premium to Reinsurance			(x)
Net Premium			xx
Add: Interest income		x	
Other Income		x	xx
Gross Income			**xx**

Less Provision for unexpired risk c/f		x	
Restricted to 45% of total premium			
-for general			
25% of total premium –			
for cargo marine		(x)	(x)
			xx
Less Allowable Expenses:			
Claims	x		
Less Claims from reinsurance	(x)	x	
Commission		x	
Other allowable Management Expenses		x	
		xx	
Restricted to 25% of total premium		(x)	(x)
Assessable profit		xx	
Less Capital Allowance		(x)	
Total profit		xx	

Tax payable shall be the higher of
Tax paid as per Total Profit Computed or
Tax paid on 15% of Gross income

(ii) **Non-Nigerian Company:** Where a non-Nigerian company engaged in non-life insurance business in Nigeria the assessable profit would be determined just like that of the Nigerian company. However, only premium received in Nigeria will be taken into consideration also only expenses incurred in Nigeria will be allowed as deduction including a fair proportion of Head Office expenses.

For a Non-Nigerian insurance company to be liable to tax in Nigeria, it must have a permanent establishment in Nigeria. "Permanent establishment" in relation to an insurance company means a branch, management or a fixed place of business in Nigeria, but does not include an agency in Nigeria unless the agent has, and habitually exercises a general authority to negotiate and conclude contracts on behalf of such company.

Where an insurance company carries on a life class and a general class insurance business, the funds and books of account of one class shall be kept separate from the other as though one class does not relate to the other class and the annual tax returns of the two classes of insurance business be made separately.

For each class of insurance business, where there are more than one type of insurance (products) in the same class, they form one type of

business and the loss of one shall be allowed against the income from another type of insurance business but the loss shall be available to be carried forward against profit from the same class of insurance business, and to such loss can be carried forward or maximum of 4 years.

(d) **REINSURANCE BUSINESS:** The assessable profit and tax liability of a company carrying on reinsurance business is determined as follows:

	N	N	N
Gross Premium			xx
Less premium to Reinsurance			(x)
Net Premium			xx
Add: Interest income		x	
Other Income		x	xx
Gross Income			xx
Less Provision for unexpired risk c/f		x	
Restricted to 45% of total premium -for general			
25% of total premium –for cargo marine		(x)	(x)
			xx
Less Allowable Expenses:			
Claims	x		
Less Claims from reinsurance	(x)	x	
Commission		x	
Other allowable Management Expenses		x	
		xx	
Restricted to 25% of total premium		(x)	(x)
Less Transfer to General Reserve			
i. General Reserve < Minimum Authorised Capital			
50% of Gross profit		x	
or			
ii. General Reserve ≥ Minimum Authorised Capital			
25% of Gross Profit		x	(x)
Assessable profit			**xx**
Less Capital Allowance			(x)
Total profit			xx

Tax payable shall be the higher of
Tax paid as per Total Profit Computed
Tax paid on 15% of Gross income

(e) **ADDITIONAL INFORMATION TO BE FILED BY INSURANCE BUSINESS**

An insurance company that engages the services of an insurance agent, a loss adjuster and an insurance broker shall include in its annual tax returns, a schedule showing the names and addresses of insurance agent, a loss adjuster and an insurance broker, the date their services were employed and terminated and payments made to them.

(f) **CABLE AND TELECOMMUNICATION COMPANIES (CITA 15)**

Where a company other than a Nigerian Company carries on the business of transmission of messages by cable or by any form of wireless apparatus, it shall be assessable to tax as though it operates ships or aircrafts, and the provisions of the preceding Section shall apply **mututis mutandus** to the computation of its profit deemed to be derived from Nigeria were equivalent to the shipping and loading of passengers, mails, livestock or goods in Nigeria.

13.4 CHAPTER REVIEW

This chapter discusses special businesses - such as shipping, air transport, insurance and cable undertakings. The peculiarities with regards to determination of the sources/nature of the Incomes/taxable Profits of each area of business under CITA, were also covered.

13.5 WORKED EXAMPLES

13.5.1 Questions

1 (a) What are the procedures in the tax computations of shipping or air transport businesses?

(b) What are the steps necessary to ascertain the Taxable Profit of Non-Nigerian Insurance Company that carries on life assurance business in Nigeria and which profit partly accrues outside Nigeria?

2 Explain the following:

(a) Unit Trust Scheme and Unit Holder

(b) How do you ascertain the profits of an Authorized Unit Scheme on which tax may be imposed?

(c) What constitutes the taxable profit of a Nigerian company in Life Insurance Business?

3. Maputo Airline is an air transport company registered in the United States of America. On its scheduled flights to West Africa, the planes

land in Lagos to convey passengers to either Amsterdam or Paris. Ticketing and other local transactions are carried out in Nigeria through an authorised agent who sells tickets and meets necessary financial obligations on behalf of Maputo airline.

The agent sold ₦6,000,000 worth of tickets on behalf of the company in 2000 and incurred the following local expenses in Nigeria:

	₦
Wages to labourers and security men	40,000
Office expenses	25,000
Electricity & rates	15,500
Trade subscription	4,500
	85,000

In order to obtain Tax Clearance Certificate for the purpose of remitting proceeds from air transport business to the home country, the agent consulted you to prepare the tax payable to the Federal Inland Revenue Service. He informed you that:

(i) 20% of total ticket sales proceeds is allowed annually by Federal Inland Revenue to cover Depreciation Allowance of Assets FIRS.

(ii) 30% of total ticket sales proceeds is allowed annually to cover share of Head Office overheads.

(iii) Local expenses in Nigeria are allowable in full.

You are required to:

(a) Compute the tax payable in Nigeria.

(b) State other option(s) for the company in computing tax payable.

4. Zenith Insurance Co. Plc is a company engaged in both Life and other insurance business. The draft IFRS account of the company for the year ended 31 December 2012 disclosed the following information:

(a) STATEMENT OF COMPREHENSIVE INCOME FOR YEAR ENDED 31 DECEMBER 2012

	Life Business	Non-Life Business	Reinsurance Business	Total
	₦'000	₦'000	₦'000	₦'000
Gross Premium written	22,000	100,000	58,000	180,000
Gross Premium income	22,000	100,000	58,000	180,000
Re-insurance Premium	0	(58,000)	0	(58,000)
Net Premium Income	22,000	42,000	58,000	122,000
Fees and Commission income	2,500	6,300	4,200	13,000
Net Underwriting Income	24,500	48,300	62,200	135,000

	₦'000	₦'000	₦'000	₦'000
Claims expenses	(12,500)	(24,000)	(21,000)	(57,500)
Re-insurance claims	6,000	15,000	0	21,000
Change in contract liabilities	700	(2,300)	0	(1,600)
Net claims expenses	(5,800)	(11,300)	(21,000)	(38,100)
Underwriting expenses:				
Acquisition expenses	(300)	(1,400)	(990)	(2,690)
Maintenance expenses	(1,550)	(4,330)	(1,800)	(7,680)
Total underwriting expenses	(1,850)	(5,730)	(2,790)	(10,370)
Underwriting Profit/(Loss)	**16,850**	**31,270**	**38,410**	**86,530**
Investment income	5,800	12,600	13,700	32,100
Other operating income	1,800	3,800	2,400	8,000
Total investment income	7,600	16,400	16,100	40,100
Impairment charges	(450)	(1,330)	(1,080)	(2,860)
Net fair value gain/loss on investment Properties	220	680	340	1,240
Net Operating Income	**7,370**	**15,750**	**15,360**	**38,480**
Expenses:				
Administrative expenses	(3,900)	(18,000)	(9,500)	(31,400)
Other operating expenses	(880)	(1,100)	(1,420)	(3,400)
Total expenses	(4,780)	(19,100)	(10,920)	(35,800)
Result of operating activities	19,440	27,920	41,850	89,210
Interest expense	(3,600)	(7,500)	(4,800)	(15,900)
Profit or (Loss) before Taxation	**15,840**	**20,420**	**38,050**	**73,310**

(b)STATEMENT OF FINANCIAL POSITION FOR YEAR ENDED 31 DECEMBER, 2012

	Life Business	Non-Life Business	Reinsurance Business	Total
Assets	₦	₦	₦	₦
Cash and Cash Equivalent	900,000	1,660,000	1,220,000	3,780,000
Financial Assets	1,600,000	2,800,000	2,300,000	6,700,000
Trade Receivable	28,000	52,000	44,000	124,000
Other Receivables	1,400	4,600	750	6,750
Investment in Subsidiary	0	3,500	0	3,500
Intangible Assets	22,000	14,900	26,000	62,900
Property Plant and equipment	1,200,000	3,550,000	2,400,000	7,150,000
Statutory Deposits	300,000	500,000	400,000	1,200,000
Total Assets	**4,051,400**	**8,585,000**	**6,390,750**	**19,027,150**

	₦	₦	₦	₦
Liabilities				
Insurance Contracts Liabilities	1,300,000	5,280,000	1,520,000	8,100,000
Investment Contract Liabilities	800,000	1,180,000	1,020,000	3,000,000
Trade Payable	11,200	18,800	16,000	46,000
Other Payables	600	1,200	130	1,930
Employee Benefit Liabilities	520	680	550	1,750
Total Liabilities	**2,112,320**	**3,480,680**	**2,556,680**	**11,149,680**
Equity				
Issued and Paid Share capital				1,200,000
Share Premium				1,800,000
General Reserve				2,600,000
Contingency Reserve				400,000
Retained Earnings				1,877,470
Shareholders' Funds				7,877,470
Total Liabilities and Reserves				**19,027,150**

Additional Information:

(i) The company distributed ₦3,500,000 surplus arising from actuarial revaluation of Life fund.

(ii) Administrative expenses included depreciation:

Life Business	Non-Life Business	Reinsurance Business
₦'000	₦'000	₦'000
960	1,200	1,050

(iii) Gross premium written from Non life business and Reinsurance business include ₦15,000,000 and ₦13,600,000 from general insurance.

(iv) Net liability on life policies as at 31 December 2012 was ₦1,297,570.

(v) Capital allowance agreed with the relevant tax authority as follows:

Life Business	Non-Life Business	Reinsurance Business
₦'000	₦'000	₦'000
250	800	650

(vi) Investment income include:

	Life Business	Non-Life Business	Reinsurance Business
	₦'000	₦'000	₦'000
Dividend (Gross)	1,200	3,000	5,500
Interest on fixed deposit	3,300	7,600	6,900
Debenture interest	1,300	2,000	1,300
	5,800	12,600	13,700

(vii) The provision for unexpired risk include:

	Life Business	Non-Life Business	Reinsurance Business
	₦'000	₦'000	₦'000
Balance B/F	900	3,000	1,220
Balance C/F	1,300	5,280	1,520

(viii) The balance of the life fund account as at 31 December 2012 was ₦1,100, 000.

(ix) The minimum authorized capital of the company is the same as the paid up capital.

Required:

Compute the company's tax liability for the relevant tax year.

13.5.2 Suggested Solutions

1 (a) The tax computation is achieved as follows:

Step 1: Identify the global income of the company

Step 2: Identify the Nigerian Income. The Nigerian Income is the income derived from the carriage of goods and passengers unto a ship or aircraft from Nigeria

Step 3: Determine the Global Adjusted Profit of the Company

Step 4: Compute the Adjusted Profit Ratio as follows:

$$\text{Adjusted Profit Ratio} = \frac{\text{Global Adjusted Profit x 100}}{\text{Global Income}}$$

Step 5: Identify the Global Depreciation charged in the account

Step 6: Identify the Global Depreciation Ratio as follows:

$$\text{Depreciation Ratio} = \frac{\text{Global Depreciation x 100}}{\text{Global Income}}$$

Step 7: Compute the Nigerian Adjusted Profit as follows: Nigerian Adjusted Profit = Adjusted Profit Ratio X Nigerian Income

Step 8: Compute the Capital Allowance for the Nigerian operation as follows:
Capital Allowance = Depreciation Ratio X Nigerian Income

Step 9: Compute the Taxable Profit for Nigerian Income Tax purpose by deducting step 8 from step 7

(b) **Non-Nigerian Company:** The assessable profit of a non-Nigerian company carrying on life assurance business is determined as follows:

	₦	₦
Investment Income (see working1)		x
Less Agency commission in Nigeria	x	
Allowable expenses in Nigeria	x	
Fair proportion of Head Office expenses	x	(x)
Assessable Profit		x

Working

Investment Income:

$$\frac{\text{Premium Receivable Nigeria}}{\text{Global Premium of the company}} \times \frac{\text{Global Investment Income}}{1}$$

2(a) (i) **Unit Trust Scheme:** This means any arrangement made 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 whatsoever.

(ii) **Unit Holder:** This is any investor, beneficiary or person who acquired units in a Unit scheme and is entitled to a share of the investment subject to the trust of a unit trust scheme.

(b) The profits of an Authorized Unit Scheme on which tax may be imposed shall be ascertained by:

(i) Taking the income accruing to the trustees from all sources of the investment of the Unit Trust, and;

(ii) Deducting therefrom sums disbursed as management expenses including remuneration for the managers.

(c) **LIFE BUSINESS**

(i) **Nigerian Company:** The Assessable profit and tax liability of a Nigerian company carrying on life insurance business is determined as follows:

	₦	₦	₦
Investment income			xx
Other Income			xx
Actuarial Revaluation Surplus distributed			xx
Gross Income			xx

	₦	₦	₦
Deduct:			
i. General Reserves	xx		
Add Life Fund A/c	xx		
	xx		
Less Net liabilities on policies	(x)	x	
ii. Special Reserve			
The higher of:			
1 % of Gross premium OR	x		
10% of Net Profit	x	x	
iii. Other allowable Management expenses		x	(x)
Assessable profit			**xx**
Less Capital Allowance			(x)
Total profit			x

Tax payable shall be the higher of:

Tax paid as per Total Profit Computed; and
Tax paid on 20% of Gross income

Note:
Annual transfer to special reserves would depend on whether the total reserves is equal to or higher than the minimum statutory paid up capital.

3(a) **MAPUTO AIRLINE – NIGERIAN INCOME COMPUTATION**

	₦
Sales proceeds	6,000,000
Deduct:	
Allowed Head Office	
expenses 30% of 6,000,000	1,800,000
Depreciation allowance 20% of 6,000,000	1,200,000
Local expenses	85,000
	3,085,000
Chargeable profit	2,915,000
Income tax at 30% thereon	874,500

Notes:
(i) The tax rate was 30% for 2000 assessment year.
(ii) The minimum of 2% of the full sums receivable in this case will give a tax of 120,000.

Since this is less than the tax computed, the tax payable will still be the tax computed, were the provision of subsection 4, that was added in 2000 to be applied.

(b) The option available to the company in computing its tax payable is as follows:
From the above, the ratio of the profit of the company before depreciation allowance to its turnover is:

$$\frac{2,915,000 + 1,200,000}{6,000,000} \text{, that is, } 68.58\%$$

The ratio of its depreciation to turnover is also fixed at 20%. It should be noted from the question that these ratios were fixed by the Federal Inland Revenue Service in Nigeria.

The Act provides that these two ratios should be certified by the tax authority (in this particular situation) of the USA, where the company was registered. Therefore, if the company feels that the ratio of profit as fixed above is excessive and or the ratio of the depreciation allowance is inadequate, the company has a period of six years within which to claim that its tax liability be recomputed on the basis of the ratios that will be certified by the USA tax authority.

If the company fails to agree with the revenue service on this matter, the provisions of CITA regarding objections and appeals shall apply with necessary modifications.

Nigerian Companies

Nigerian companies engaged in shipping or air transport business will be subjected to tax as any other company incorporated in Nigeria. It is their global income that will be subjected to income tax subject to the provisions of any applicable double taxation agreement and or any exemption in other parts of the Act CITA.

Business of transmission of messages

The above also apply to a company other than a Nigerian company carrying on the business of transmission of messages by cable or by any form of wireless apparatus. The provisions shall apply "mutatis mutandis" to the computation of its profits, deemed to be derived from

Nigeria as though the transmission of messages to places outside Nigeria were equivalent to the shipping or loading of passengers, mails, livestock or goods in Nigeria (CITA Section 13).

4. **ZENITH INSURANCE CO. PLC**
COMPUTATION OF TAX LIABILITY FOR 2013 TAX YEAR

(a) **LIFE BUSINESS:**

	₦'000	₦'000	₦'000
Investment income:			
Interest on fixed deposit		3,300	
Debenture interest		1,300	4,600
Other Income:			
Fees and Commission income			2,500
Other operating income			1,800
Actuarial Revaluation Surplus distributed			3,500
Gross Income			12,400
Deduct:			
i. General Reserves	2,600		
Add Life Fund A/c	1,100		
	3,700		
Less Net liabilities on policies	(1,298)	2,402	
ii. Special Reserve			
The higher of:			
1 % of Gross premium - 22,000 x 1%	220		
10% of Net Profit – 15,840 x 10%	1,584	1,584	
iii. Other allowable Management expenses:			
Administrative expenses – (3,900 – 960)	2,940		
Interest expense	3,600		
Other operating expenses	880	7,420	(11,406)
Assessable profit			**994**
Less Capital Allowance			(250)
Total profit			744
Tax payable shall be the higher of:			
Tax @ 30% on total profit computed OR			223.1
Tax paid on 20% of Gross income			
₦12,400 x 20%			2,480
:. Tax payable			**2,480**

(b) NON LIFE BUSINESS:

	₦'000	₦'000	₦'000
Gross Premium		100,000	
Less premium to Reinsurance		(58,000)	
Net Premium			42,000
Add: Interest income:			
Fees and Commission income		7,600	
Other operating income		2,000	
Other Income		3.800	13,400
Gross Income			55,400
Less Provision for unexpired risk c/f	5,280		
Restricted to 45% of total premium			
-for general ₦100,000 x 45%	45,000		
:. Provision for unexpired risk c/f			(5,280)
			50,120
Less Allowable Expenses:			
Administrative expenses			
– ₦(18,000 – 1,200)	16,800		
Other operating expenses	1,100	17,900	
Claims expenses	24,000		
Re-insurance claims	(15,000)	9,000	
Interest expense		7,500	
		34,400	
Restricted to 25% of total premium			
₦100,000 x 25%		(25,000)	(25,000)
Assessable profit			**25,120**
Less Capital Allowance			(800)
Total profit			24,320
Tax payable shall be the higher of:			
Tax paid as per Total Profit Computed			
₦24,320 x 30%			7,296
Tax paid on 15% of Gross income			
₦55,400 x 15%			8,310
:. Tax payable			**8,310**

(c) REINSURANCE BUSINESS:

	₦	₦	₦
Gross Premium		58,000	
Less premium to Reinsurance		(0)	
Net Premium			58,000
Add: Interest income			
Interest on fixed deposit		6,900	
Debenture interest		1,300	
Other operating income		2,400	10,600
Gross Income			**68,600**
Less Provision for unexpired risk c/f		1,520	
Restricted to 45% of total premium for general			
58,000 x 45%		26,100	
:. Provision for unexpired risk c/f			(1,520)
			67,080
Less Allowable Expenses:			
Administrative expenses– ₦(9,500-1,050)	8,450		
Other operating expenses	1,420	9,870	
Claims expenses	21,000		
Re-insurance claims	(0)	21,000	
Interest expense		4,800	
		35,670	
Restricted to 25% of total premium			
₦58,000 x 25%		14,500	(14,500)
Less Transfer to General Reserve			
i. General Reserve < Minimum Authorised Capital			
50% of Gross profit			
or			
ii. General Reserve ≥ Minimum Authorised Capital			
25% of Gross Profit			
₦38,410 x 25%			(9,602.5)
Assessable profit			**42,977.5**
Less Capital Allowance			(650)
Total profit			**42,327.5**
Tax payable shall be the higher of:			
Tax paid as per Total Profit Computed			
₦42,327.5 x 30% OR			12,698.3
Tax paid on 15% of Gross income			
₦68,600 x 15%			10,290
:. Tax payable			**12,698.3**

(d) ZENITH INSURANCE CO. PLC
SUMMARY OF TAX LIABILITY FOR 2013 TAX YEAR

	Life Business	Non-Life Business	Reinsurance Business	Total
	₦'000	₦'000	₦'000	₦'000
Tax payable	2,480	8,310	12,698.3	3,488.3
Education Tax	19.872	502.4	859.55	1,381.822
Total Tax Payable	2,499.872	8,812.4	13,557.85	4,870.122

CHAPTER 14

Petroleum Profits Tax

Contents

1. Purpose
2. Introduction
3. Definitions as Given in PPTA
4. Administration of Petroleum Profits Tax Act
5. Nature and Classification of Income
6. Nature and Classification of Costs
7. Ascertainment of Adjusted Profits and Imposition of Tax
8. Allowable and Non-allowable Deductions
9. Treatment of Losses in Petroleum Profits Tax Computations
10. Capital Allowances
11. Ascertainment of Assessable Tax and Chargeable Tax
12. Concepts and Computations of Posted Prices
13. Business sold or Transferred
14. Reconstituted Company
15. Accounts and Particulars
16. Assessment and Appeal Procedures
17. Persons Chargeable
18. Collection and Repayment of Tax
19. Deduction of Tax at Source
20. Offences and Penalties
21. Double Taxation Arrangements
22. Memorandum of Understanding (MOU)
23. Companies Engaged in Utilization of Associated Gas
24. Joint Venture and Production Sharing Contracts
25. Chapter Review
26. Worked Examples

14

PETROLEUM PROFITS TAX

14.0 PURPOSE

After studying this chapter, readers should be able to:

(a) know how the Petroleum Profits Tax Act (PPTA) is administered and how to deal with the Revenue Service in connection with the tax

(b) know and understand the definitions of some principal terms or concepts under PPTA.

(c) have the knowledge of the concept and computation of posted prices.

(d) understand the nature and classification of income and costs in a petroleum operation environment.

(e) know how to arrive at the adjusted/ assessable profits of a company engaged in petroleum operations.

(f) understand the principle of allowable and non-allowable deductions as applicable to petroleum profits tax.

(g) compute capital allowances for petroleum profits tax purposes.

(h) be familiar with Memorandum of Understanding (MOU) as applicable to companies engaged in petroleum operations.

(i) know the incentives available to companies engaged in the utilization of associated gas.

(j) understand Joint Venture contracts and Production Sharing Contracts as they apply to petroleum companies.

(k) prepare petroleum profits tax computations in accordance with the relevant provisions of the Act.

14.1 INTRODUCTION

In 1908, a German Company called "The Nigerian Bitumen Company" began the search for crude oil in Nigeria. The license granted was for exploration of Petroleum at Araromi in the present day Ondo State. The outbreak of the First World War in 1914 brought a halt to this adventure. The Company did not resume operations after the war because of the discouraging results during its operating period.

In 1937, Shell D'Arcy was granted exploration licenses to cover the entire Nation. This adventure again was suspended at the outbreak of the Second World War in 1941 only to resume later in 1946. It was the amalgamation of Shell D'Arcy and British Petroleum (BP) that gave rise to Shell Petroleum Development Nigeria Limited which eventually discovered oil in commercial quantity after a decade i.e 1956 at Oloibiri in the present day Niger Delta area of the country. The first oil field began production in 1958. Oil was discovered later in other areas of both Rivers and Bayelsa States.

The Shell BP, an Anglo/Dutch Company initially had the monopoly of oil prospecting in Nigeria, but was later joined by other oil companies like Mobil, Texaco Overseas, Agip and Gulf.

Petroleum activities are grouped under two categories, Upstream and Downstream.

Upstream Activities: These activities are related to the acquisition of licenses, exploration, development and production of crude oil and gas; treatment of oil and processing of gas as well as transportation and delivery to export terminals refineries or other processing plants.

These activities are taxed under the Petroleum Profits Tax, Act Cap P13 LFN 2004. This Act was first enacted in 1959; with retrospective effective date of 1st January 1958.

Downstream Activities: As defined by Nigerian Accounting Standard Board (Now Financial Reporting Council) they are those activities that take place from receipt of crude oil into crude oil tanks or gas into petro chemical tanks to the transportation of refined products to the final user or of processed products to secondary industries.

These activities encompass transporting, refining, liquefaction of natural gas, distributing and marketing of refined petroleum products, gas and derivatives. Companies engaged in downstream operations are subject to tax under the Companies Income Tax Act Cap C21 LFN 2004 – These include marketing companies, independent marketers and servicing companies.

The Regulatory Agencies in the Oil and Gas Sectors include the following:

(a) **Nigerian National Petroleum Corporation (NNPC)**
This was established by Act No 33 of 1st April 1977. NNPC is the sole authority over the Petroleum Activities in Nigeria.

NNPC through its subsidiaries is involved in exploration, production, transportation, processing of oil, refining, marketing of crude oil and derivatives.

(b) FIRS – The powers and duties of the FIRS with respect to the administration of Petroleum Profit Tax Act Cap P13 LFN 2004 are stated under Section 3 of the Act. The schedule specifically highlighted the powers and duties that cannot be delegated by the FIRS under Sections 3(b), (d) and (e); 6(2); 10(1)(k); 13(3)(c); 15, 31(2); 33(1); 37(1); 49, 52, 53 and 58 of the Act.

(c) **Department of Petroleum Resources (DPR)** – This is the arm of the Ministry of Petroleum Resources that is charged with the responsibility of regulation and supervision of all operations under license and leases in the Oil and Gas Industries which includes exploration, production and marketing of crude oil and refined petroleum products.

(d) Subsidiaries of Nigeria National Petroleum Company:

(i) **National Petroleum Investment Management Services (NAPIMS)** – This is the investment arm of NNPC which administers NNPC share of Joint Venture Operations.

(ii) **The Petroleum Products Marketing Companies (PPMC)** – These companies have the responsibility of selling refined petroleum and finished products which include gasoline, diesel, engine oil grease and other derivatives.

(iii) **Nigerian Petroleum Development Company (NPDC)** – This is the arm of NNPC that is engaged in the following areas:

- Exploration – Seismic acquisition/processing – analysis exploratory, drilling and testing
- Appraisal –Drilling of appraisal wells, re-evaluation survey testing
- Development – Drilling/Development of wells, production, optimization, well engineering and field survey
- Production - Intervention and stimulation of production optimization
- Abandonment – Environmental impact assessment (EIA) effluent monitoring, testing/facilities demobilisation, remediation and decommissioning.
- NPDC has Joint Partners e.g Shell Petroleum Development Company and Chevron Nigeria Limited (SPDC and CNL) and Service Contract Partners

(v) The Nigerian Petrochemical Companies in Kaduna and Warri.

(vi) The Refineries (2 in Port Harcourt) one each in Warri and Kaduna.

(e) The Central Bank of Nigeria

Sale of crude oil is paid for in foreign currency into Federal Government Designated bank overseas: The proceed is then transferred into the Federation Account in the Central Bank of Nigeria and Federal Inland Revenue Service is notified through payment advice.

(f) Marginal Fields Operators

Marginal Fields are field discovered by large International Oil Companies or NNPC and which as a result of other investment options were not developed or relinquished. They represent investment potential for small companies with workable operations. Such fields hold an estimated of 2 billion barrels per day.

In its publication, the Department of Petroleum Resources mentioned that the Federal Government is favourably disposed to Joint Application and has set up a committee comprising the representative of DPR, leaseholders, and financial advisers to assess submission with the aim of identifying the company most likely to be successful in operating the marginal fields as well as further develop the Nigerian Oil Industry Companies that are prequalified are notified and given further instructions on how to prepare and submit a more detailed technical and commercial bid conditions for eligibility are. The conditions are:

(i) At least 51% of the beneficial interest of the company must be owned by Nigerian citizens

(ii) No single shareholder may own more than 25% of the shares in the company

(iii) The company must have upstream oil and gas experience

(iv) The companies Memorandum and Articles of Incorporation must authorize the company to conduct oil and gas exploration and production activities.

Foreign Companies may participate in the process by either incorporating a Nigerian branch with the Corporate Affairs Sole Risk (Independent) Operations

- Participation by indigenous operators who bear all the risks and take all the crude produced

- Lack of incentives as in Joint Venture and Production Sharing Contract

- Many operators unable to produce up to the commercial quantity of at least 10,000 barrels per day

- Being capital intensive, where there is no discovery of oil, it would be difficult to write off the production expenses without any income

- Most operators are unable to get equity finance

- Some operators go into technical partnership so as to meet capital requirement under this arrangement, the technical partner recoups its costs with **cost oil**, pays Royalty and tax oil and share what is left.

- Tax rateof 85% is a burden

- Tax rate at 65.75% during the period of recouping the pre-production expenses

- Technical partners eager to recoup cost hence dubious clauses are inserted into the agreement leaving almost nothing for local partners

The Oil industry has achieved great prominence in the Nigerian economic environment since the early seventies. The influence of oil and gas on the Nigerian economy today cannot be overemphasized. The oil and gas industry accounts for over 90% of the country's foreign exchange earnings. It also plays a predominant role in the Gross National Product (GNP) index.

It is in view of the importance that Government attaches to oil exploration and production that the taxation of profits or gains of companies engaging in such operations are taxable under a separate tax law. The applicable law is the Petroleum Profits Tax Act (PPTA), which was first enacted in 1959 with retrospective effective date of 1 January, 1958. This principal Act and all amendments thereto have been re-enacted as Chapter P13 of the Laws of the Federation of Nigeria (LFN) 2004.

'Petroleum operations' as defined in the Act essentially involves petroleum exploration, development, production and sale of crude oil and gas. There is no distinction in the Act between associated and non-associated gas. All activities of petroleum companies that are to be taxed under PPTA are referred to as Upstream operations. Those that are not covered under the definition of "petroleum operations" are referred to as downstream operations. Examples of downstream operations are

petroleum refining, petroleum marketing and gas utilisation projects. Companies engaged in downstream operations are subject to tax under the Companies Income Tax Act Cap C21 LFN 2004.

PPTA provides a framework for the understanding of the Nigerian petroleum tax regime. Recourse must still be made to the various contractual arrangements, Memoranda Of Understanding and side letters that provide information on the incentives made available by Government to the operators in the oil and gas industry. These are additional to the provisions of the PPTA and are usually applied as if they were part of the provisions of the Act.

14.2 DEFINITIONS AS GIVEN IN PPTA

All terms relate to companies engaged in petroleum operations.

Accounting period

(a) This is a period of one year commencing on 1st January and ending on 31st December of the same year; or

(b) Any shorter period commencing on the day the company first makes a sale or bulk disposal of chargeable oil under a programme of continuous production and sales, domestic, export or both, and ending on 31st December of the same year, or

(c) Any period of less than a year being a period commencing on 1st January of any year and ending on the date in the same year, when the company ceases to be engaged in petroleum operations.

Revenue Service

The Federal Inland Revenue Service.

Casinghead petroleum spirit

Any liquid hydrocarbons obtained in Nigeria from natural gas by separation or by any chemical or physical process but before the same has been refined or otherwise treated. Casinghead petroleum spirit is further subdivided into two, namely:

(a) **Chargeable natural gas**
Natural gas actually delivered by a company to the Nigerian National Petroleum Corporation under a Gas Sales contract but does not include natural gas taken by or on behalf of the Government of the Federation.

(b) **Chargeable oil**
Casinghead petroleum spirit and crude oil won or obtained by a company from petroleum operations.

Company

Any body corporate incorporated under any law in force in Nigeria or elsewhere.

Crude oil

Any oil (other than oil extracted by destructive distillation from coal, bituminous shales, or other stratified deposits) won in Nigeria, either in its natural state or after the extraction of water, sand or other foreign substance therefrom but before any such oil is refined or otherwise treated.

Disposal or disposed of

In relation to chargeable oil owned by a company, disposal or disposed of connotes respectively:

(a) Delivery, without sale, of chargeable oil to; and

(b) Chargeable oil delivered, without sale to, a refinery or to an adjacent storage tank for refining by the company.

G-Factor

Gas production cost adjustment factor.

High Court

The High Court in Nigeria within whose jurisdiction is the place:

(a) In relation to any offence under the PPT Act, where such offence is deemed to have occurred;

(b) In relation to any suit for tax or appeal against an assessment of tax, where the tax return has been submitted or where the assessment of the tax was made as the case may be;

(c) In relation to where the Revenue Service directs a company to keep proper books of accounts, in accordance with the relevant provisions of the Act, from where the direction was issued; and

(d) In relation to any claim or other matter which is subject to appeal in like manner as an assessment, where the claim or other matter was refused by the Revenue Service.

Intangible drilling costs

All expenditure for labour, fuel, repairs, maintenance, hauling, and supplies and materials (not being supplies and materials for well cement, casing or other well fixtures) which are for or incidental to drilling, cleaning, deepening or completing wells or the preparation thereof incurred in respect of:

(a) Determination of well locations, geological studies and topographical and geophysical surveys preparatory to drilling;

(b) Drilling, shooting, testing and cleaning wells;

(c) Cleaning, draining and leveling land, road-building and the laying of foundations;

(d) Erection of rigs and tankage assembly and installation of pipelines and other plant and equipment required in the preparation of drilling of wells producing petroleum.

Liquefied natural gas
Natural gas in its liquid state at approximately atmospheric pressure.

Minister
Minister charged with responsibility for matters relating to taxes on incomes and profits.

MMcf
One million cubic feet

Natural gas
Gas obtained in Nigeria from bore holes and wells consisting primarily of hydrocarbons.

Nigeria
Includes the submarine areas beneath the territorial waters of Nigeria and the submarine areas beneath any other waters which are or at any time shall in respect of mines and minerals become subject to the legislative competence of the National Assembly.

Non-productive rents
The amount of any rent for which there is provision for its deduction from the amount of any royalties under an oil prospecting licence or oil mining lease, to the extent that such rent is not so deducted.

Oil Mining Lease
A lease granted to a company under the Minerals Act, for the purpose of winning petroleum, or any assignment of such lease.

Oil Prospecting Licence
A licence granted to a company under the Minerals Act, for the purpose of winning petroleum, or any assignment of such licence.

Person
Includes a company and any unincorporated body of persons.

Petroleum
Any mineral oil or relative hydrocarbon and natural gas existing in its natural condition in Nigeria, but does not include liquefied natural gas, coal,

bituminous shales or other stratified deposits from which oil can be extracted by destructive distillation.

Petroleum Operations

The winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in the course of a business carried on by the company engaged in such operations, and all operations incidental thereto and any sale of or any disposal of chargeable oil by or on behalf of the company.

Resident in Nigeria

In relation to a company, this means a company, the control and management of the business of which are exercised in Nigeria.

Royalties

(a) The amount of any rent for which there is provision for its deduction from the amount of any royalties under an oil prospecting licence or oil mining lease to the extent that such rent is so deducted; and

(b) The amount of any royalties payable under any such licence or lease less any such rent deducted from those royalties.

Concession

This includes an oil exploration licence, an oil prospecting licence, an oil mining lease, any right, title or interest in or to petroleum oil in the ground and any option of acquiring any such right, title or interest;

Lease

This includes an agreement for a lease where the term to be covered by the lease has begun, any tenancy and any agreement for the letting or hiring out of an asset, but does not include a mortgage, and all cognate expressions including "leasehold interest" shall be construed accordingly.

14.3 ADMINISTRATION OF PETROLEUM PROFITS TAX ACT

The administration of the Petroleum Profits Tax Act is under the charge and management of the Federal Inland Revenue Service. The Revenue Service may do all acts as 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 to the Federal Minister of Finance through its Revenue Service.

Whenever the FIRS consider it necessary with respect to any tax due, it may acquire, hold and dispose of any property taken as security for or in satisfaction of any tax or of any judgment debt due in respect of any tax and shall account for any such property and the proceeds of sale thereof in a manner to be prescribed by the Minister (Section 3(b)).

The Revenue Service may sue and be sued in its official name (Section 3(c)).

Delegation

Subject to such conditions as the Revenue Service may specify, the Revenue Service may by notice in the Federal Gazette direct that any information return or documents required to be supplied, forwarded or given to the Revenue Service may be supplied to such other person whether within or without Nigeria as the Revenue Service may direct.

The Revenue Service may by notice in the Federal Gazette or in writing authorize any person within or without Nigeria to:

(a) perform or exercise, on behalf of the Revenue Service, any power or duty conferred upon the Revenue Service other than the powers or duties specified in the First Schedule.

and

(b) receive any notice or other document to be given, delivered or served upon the Revenue Service under or in consequence of the Act or any subsidiary legislation made thereunder (Section 3(e)).

The powers or duties specified in the First Schedule that cannot be delegated by the Revenue Service are:

Section 32(2) Revenue Service to call for returns

Section 33(1) Returns Estimated tax

Section 37(1) Making of Assessments

(a) Powers and duties of the FIRS should be as stipulated in the PPTA Act, Section 3(b) With respect to any tax due;

(b) The Revenue Service may acquire, hold and dispose of any property taken as security for or in satisfaction of any tax or of any judgment debt due in respect of any tax and shall account for any such property and the proceeds of sale thereof;

(c) Section 3(d) The Revenue Service may by notice in the Federal Gazette direct that any information, return or documents required to be supplied forwarded or given to the Revenue Service may be supplied to such other person as the Revenue Service may direct;

(d) Section 6(2) The Revenue Service may, from time to time, specify the form of returns, claims statements and notices under the Act;

(e) Section 15 The Revenue Service powers under the artificial transaction provisions;

(f) Section 31 The Revenue Service power to call for further information;

(g) Section 37 The Revenue Service power to make assessments;

(h) Section 49 The Revenue Service power to grant relief for error or mistake;

(i) Section 52 The Revenue Service power to levy penalty for making incorrect accounts;

(j) Section 53 The Revenue Service power to levy a fine in respect of false statements and returns; and

(k) Section 58 The power of the Revenue Service to commence prosecution in respect of an offence.

Control by the Minister

In the exercise of the powers and duties conferred upon it, the Revenue Service shall be subject to the authority, direction, and control of the Federal Minister of Finance. Any written direction, order or instruction given by the Minister after consultation with the Chairman of the Revenue Service shall be carried out by the Revenue Service.

However, the Minister shall not give any such direction etc. in respect of any particular company which would have the effect of requiring the Revenue Service to increase or decrease any assessment made or to be imposed upon or any relief given or to be given to or defer the collection of any tax, penalty or judgement debt due by such company or which would have the effect of altering the normal course of any proceedings, whether civil or criminal, relating either to the recovery of any tax or penalty or to an offence relating to the tax. Any act, matter or thing done by or with the authority of the Revenue Service in pursuance of the provisions of PPTA shall not be subject to challenge on the ground that such was not or was not proved to be in accordance with any direction, order or instruction given by the Minister.

Signification and Execution of Powers, etc: Section 4

(a) Anything required to be done by the Revenue Service, in relation to the powers or duties specified in the First Schedule to the Act, may be signified under the hand of the Chairman of the Revenue Service Board, or of an officer of the Federal Inland Revenue Service Board who has been authorised by the Revenue Service to signify from time to time, anything done or to be done by the Revenue Service in respect of such powers or duties.

(b) Any authorisation given by the Revenue Service Board under or by virtue of the Act shall be signified under the hand of the Chairman of the Revenue Service Board unless such authority is notified in the Federal Gazette.

(c) Subject to subsection (1) of this Section, any notice or other document to be given under the Act shall be valid if -

  (i) It is signed by the Chairman of the Revenue Service Board or by any person authorised by him; or

  (ii) Such notice or document is printed and the official name of the Revenue Service Board is duly printed or stamped thereon.

(d) Every notice, authorisation or other document purporting to be a notice, authorisation or other document duly given and signified, notified or bearing the official name of the Revenue Service, in accordance with the provisions of this Section, shall be deemed to be so given and signified, notified or otherwise without further proof, until the contrary is shown.

Duty of Confidentiality (Section 5)

Every person having possession of or control over any documents, information, returns or assessment lists or copies of such lists relating to tax or petroleum operations or the amount and value of chargeable oil won by any company who at any time communicates or attempts to communicate such information or anything contained in such documents, returns, lists, or copies to any person:

(a) Other than a person to whom he is authorised by the Minister to communicate it; or

(b) Otherwise than for the purpose of the Act or of any Act or law, relating to a tax upon income, in force in any part of Nigeria; shall be guilty of an offence.

No person appointed or employed to carry out the provision of the Acts shall be required to produce in any court any return, document or assessment, or to divulge or communicate to any court any matter or thing coming under his notice in the performance of his duties under the Act except as may be necessary for the purpose of carrying into effect the provisions of the Act, or in order to institute a prosecution, or in the course of a prosecution for any offence committed in relation to tax.

The obligation as to secrecy shall not prevent the disclosure of necessary information to the authorised officers of the Government of such other country as might be necessary for double taxation relief purposes.

The Auditor-General of the Federation or any other officer authorised by him may not be prevented from having access to such records or documents as may be necessary for the performance of his official duties. The Auditor-General or any such official shall be deemed to be a person employed in carrying out the provisions of the Act for the purposes of secrecy.

Service of Notice (Section 7)

Any notice to be served in pursuance of the provisions of the Act can be served either personally or by registered post. Where a notice is sent by registered post, it shall be deemed to have been served on the day succeeding the day on which the addressee of the registered letter containing the notice would have been informed in the ordinary course of events that such registered letter is awaiting him at a post office.

Provided that a notice shall not be deemed to have been served if the addressee proves that no notification, informing him of the fact that the registered letter

is awaiting him at a Post Office, was left at the address given on such registered letter.

A notice to be served shall be addressed:

(a) in the case of a company incorporated in Nigeria, to the registered office of the company; and

(b) in the case of a company incorporated outside Nigeria either to the individual authorised to accept service of process under the Companies and Allied Matters Act at the address filed with the Registrar-General, or to the registered office of the company wherever it may be situated.

Where service of any notice has proved impossible, the notice may be served by being left at the appropriate office or address as determined above, unless such address is a registered post office box number.

14.4 NATURE AND CLASSIFICATION OF INCOME

The oil and gas industry is characterised by certain factors that are peculiar to the industry. One of these is the time lag (could be several years) between the time that an investment is made for exploratory activities and the time that the oil can be produced in commercial quantity and sold to generate income. There is the high risk and uncertainty of the results that will be obtained from exploration activities. The only conclusive evidence of the availability of oil in any location can only be obtained by drilling. The risk is very high of not finding recoverable oil reserves or not finding such in commercial quantity. Statistics have it that on the average, oil will be found in commercial quantity in one out of forty exploratory wells. Other risks that are present in the oil and gas industry are: market risk; sovereign/political risk; partner risk; and taxation risk. All these would impact greatly on the investments and return on investments in the industry.

The very high returns in the industry are to compensate for the very high risks. The industry deals in high volume of production with all the advantages of economies of scale. Financial returns are usually substantial whenever there are large finds. Profitability can also be very high in periods of high oil prices as the situation was in the 3rd quarter of 2008 when oil price reached an all time high of $145 per barrel.

The main sources of income of a petroleum producing company are:

(a) Sale of crude oil: Export and Local (Equity share)

(b) Sale of gas: Export and Local (Equity share)

(c) Income from lifting and sale of NNPC equity crude

Other items of income, for example, interest income, would be earned from activities that are considered to be incidental to petroleum operations. Incidental income will be subject to Petroleum Profits Tax. Some of the income that could be treated as incidental income are:

(a) Ullage fees
(b) Rentals
(c) Management fees
(d) Mineral Property conveyance
(e) Interest on fixed deposits

Balancing charge on disposal of items of qualifying expenditure is also to be treated as incidental income in the computation of Petroleum Profits Tax. (Gains or losses on their disposal, are excluded from the Petroleum Profits Tax computations).

Another point worthy of note in the determination of income in the oil and gas industry, is that oil produced is deemed sold when produced. As a result of this the sales value of crude oil produced can be taken to income immediately without waiting until the time of actual sales.

14.5 NATURE AND CLASSIFICATION OF COSTS

An important taxation principle is that for a business expense to be an allowable deduction, it must have been incurred in the production of the income that is being subject to the tax. For example: "............. for the purpose of ascertaining the profit or loss of any company of any period from any source chargeable with tax under the Act, there shall be deducted all expenses for that period by that company wholly, exclusively, necessarily and reasonably incurred in the production of those profits ...." (Section 24 Companies Income Tax Act CAP C21 LFN 2004).

The relevant part in PPTA is Section 9. The comparable condition stated in this Section for the allowability of expenses for tax purposes is that such must be incurred for the purpose of its petroleum operations. Note that there was no specification that it must be incurred "in the production of the income or profits."

The nature of petroleum operations business necessarily requires that certain expenses have to be incurred for the business that could not be tied directly to the income produced. It is clear that such would have been incurred for the petroleum operations albeit have not produced income/profits. The fact that they have not produced income is recognised in PPTA as insufficient ground to disallow them in PPT computations. The expense headings in this category are:

(a) Outgoings on unproductive leases (Section 10 deductible or if capitalised, capital allowances will be claimed in accordance with the provisions of the Second Schedule);
(b) Non-productive rents – Section 10 deductible;
(c) Tangible costs directly incurred in connection with drilling and appraisal of development well. (Section 10 deductible or capital allowances granted in accordance with the provisions of the Second Schedule);
(d) Exploration and drilling costs, including costs relating to the drilling of the first two appraisal wells in a particular field. (Section 10 deductible

or capital allowance granted in accordance with the provisions of the Second Schedule);

(e) All sums by way of duty, customs and excise duties, stamp duties, education tax, (amendment in Act No. 18 of 1998 included education tax with effect from 1/1/96), tax (other than PPT) or any other rate, fee or other like charges Section 10 deductible;

(f) All sums by way of customs or excise duty or other-like charges levied in respect of machinery, equipment and other goods used in the company's petroleum operations. Section 10 deductible; and

(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. Section 10 deductible.

Classification of Costs

The following are the classifications of costs in the upstream sector of the petroleum producing industry:

(a) Mineral rights acquisition costs;
(b) Exploration and drilling costs;
(c) Development costs;
(d) Production costs;
(e) Support equipment and facilities costs;
(f) General costs.

Mineral Rights Acquisition Costs

Mineral rights acquisition costs are incurred in acquiring concession rights in a lease area. They include signature bonus (initial consideration paid by the lessee to the lessor), legal fees, local statutory land acquisition fees/levies, reserves value fees, etc. Acquisition costs may relate to proved or unproved properties. Costs incurred to purchase, lease, or otherwise acquire an item (whether proved or unproved) are initially capitalised when incurred. They include the costs of:

Oil Prospecting Licence (OPL); (to search for oil)
Oil Exploration Licence (OEL); (to explore for petroleum)
Oil Mining Lease (OML); (to win, work, carry away and dispose of petroleum)
Bonuses and options to purchase or lease properties;
Minerals, when land including mineral rights purchased; and
Recording fees, legal and other costs incurred in acquiring properties

Pre-licence costs are those incurred in the period, prior to the acquisition of a legal right to explore for oil and gas in a particular location. Such costs include those incurred on the acquisition of speculative seismic data and expenditure on the subsequent geological and geophysical analysis of the data.

Exploration and Drilling Costs

Exploration and Appraisal costs are incurred in the search for oil and gas deposits after obtaining a licence, but before a decision is taken to develop a reservoir.

Exploration and drilling involve:

(a) Identifying areas that may warrant evaluation; and

(b) Evaluating specific areas that are considered to have petroleum prospects largely through the drilling of exploratory wells.

Exploration costs may be incurred both before obtaining concessions (sometimes, referred to in part as pre-licence costs) and after acquiring concession.

Principal types of exploration costs, which include depreciation and applicable operating costs of support equipment and facilities and other costs of exploration activities, are:

(a) Costs of geological and geophysical studies, rights of access to properties to conduct those studies, and salaries and other expenses of geologists, geophysical crews, and others conducting those studies;

(b) Costs of carrying and retaining undeveloped properties, such as rentals, legal costs for title deeds, stamp duties, and the maintenance of lease records;

(c) Dry hole contributions and bottom hole contributions;

(d) Costs of drilling and equipping exploratory wells; and

(e) Other associated costs such as re-settlement of local communities, compensation for economic crops, surface rights and road building.

Exploration costs include appraisal costs which are incurred, to determine the size and characteristics of a reservoir discovered, in order to assess its commercial potentials. The costs of drilling exploratory wells are usually capitalised as part of the company's uncompleted wells, equipment and facilities pending determination of whether the well has proved reserves. If the well has proved reserves, the capitalised costs of drilling the well become part of the company's wells and related equipment and facilities (though the well may not be completed as a producing well). On the other hand, if the well is dry, the treatment will depend on the accounting method adopted by the company (that is full costs or successful efforts method).

An exploratory well may have found oil and gas reserves, but classification of those reserves as proved reserves cannot be made until drilling is completed.

On completion of drilling, classification of the reserves depend on whether a major capital expenditure can be justified, which in turn, depends on whether additional appraisal wells confirm sufficient quantities of reserves. This

situation arises principally with exploratory wells drilled in remote areas for which production would require construction of a network of pipelines and/or production facilities.

In such a case, the cost of drilling the exploratory well is usually carried as an asset provided sufficient quantity of reserve to justify its completion as a producing well exists and the drilling of additional wells has been firmly planned for the near future. Otherwise, the exploratory well is considered impaired and the exploratory well costs written off if the company adopts successful efforts method of accounting. It is not unusual for oil companies to carry wells in progress for more than two years before a decision is taken to capitalise or expense costs of exploration or appraisal activities.

Development Costs

Development costs are incurred to obtain access to proved reserves and provide facilities for extracting, gathering, treating, and storing the oil and gas. These costs are incurred after a decision has been taken to develop a field or reservoir, and include the following:

(a) Drilling, equipping and testing development and production wells;

(b) Production platforms, down hole and wellhead equipment, pipelines, production and initial treatment and storage facilities as well as utility and waste disposal systems; and

(c) Improved recovery systems and equipment

Development costs are usually capitalised as part of the costs of a company's wells and related equipment and facilities. Thus, all costs incurred to drill and equip development wells and service wells are development costs and are capitalised whether the well is successful or unsuccessful. Costs of drilling those wells and costs of constructing equipment and facilities are usually included in the company's uncompleted wells, equipment and facilities until drilling or construction is completed.

Production Costs

Production costs are the recurrent costs incurred in oil and gas production activities. Production involves lifting the oil and gas to the surface, gathering, treating, field processing and storage. Production costs are usually determined to be all costs incurred from the maintenance of the wells and well heads to the storage facilities when the oil and gas are ready for export or delivery to a refinery.

Production costs are those incurred to operate and maintain a company's wells and related equipment and facilities, including depreciation, depletion and applicable operating costs of support equipment and facilities. Examples of production costs are:

(a) Costs of personnel engaged in the operation of wells and related equipment and facilities;

(b) Repairs and maintenance of production facilities;

(c) Materials, supplies, fuel consumed and services utilised in such operations; and

(d) Royalties.

Support Equipment and Facilities Costs

Costs incurred on support equipment and facilities in oil and gas producing activities, such as vehicles, repair shops, warehouses, supply points, camps, and divisional, district or field offices, aircraft and helicopters, safety and environmental facilities are usually accumulated and reallocated to the classes of costs identified above on some rational basis. For example, use of vehicles may be reallocated on kilometres, use of power house on the basis of wattage reading, and so on.

General Costs

Some costs incurred in a company's oil and gas producing activities do not always result in acquisition of an asset and therefore are usually charged to expense. Examples include geological and geophysical costs, the costs of carrying and retaining undeveloped properties, and the cost of drilling those exploratory wells that do not result in proved reserves.

The costs of a company's wells and related equipment and facilities and the costs of the related proved properties are usually amortised as the related oil and gas reserves are produced from the reserves. Depreciation, depletion, and amortization of capitalised acquisition, exploration, and development costs also become part of the cost of oil and gas produced along with production (lifting) costs identified above.

Oil companies incur substantial costs in providing amenities for the communities where they operate. Such costs which do not have future benefits to the company are usually expensed. Oil companies also incur costs on such matters as corporate affairs, staff training and development.

14.6 ASCERTAINMENT OF ADJUSTED PROFITS AND IMPOSITION OF TAX

Imposition

Section 8 of the PPTA levies tax on the profits of each accounting period of any company engaged in petroleum operations. Particular note should be taken of the fact that the basis period for any assessment year is the same as the accounting period of the company, that is the assessment is on current year

basis. For example, assessment for the 1998 assessment year of a company that has been engaged in petroleum operations for several years will be based on the result of the accounting period of the company commencing from 1 January, 1998 and ending on 31 December, 1998. This is a major departure from the preceding year rule that is applicable in the taxation of individuals (under Personal Income Tax Act) and companies not engaged in petroleum operations (taxable under Companies Income Tax Act).

The profits of an accounting period

The profits of a company for an accounting period is computed as the aggregate of the following:

(a) the proceeds of sale of all chargeable oil sold;
(b) the value of chargeable oil disposed of;
(c) the value of all chargeable natural gas; and
(d) all income incidental to and arising from one or more of its petroleum operations.

In respect of (b) above, the value to be used shall be the aggregate of:

(i) value of the chargeable oil as determined for royalty purposes;
(ii) the cost of extraction of that oil deducted in determining its value; and
(iii) any cost incurred by the company in transportation and storage of that oil between the field of production and the place of its disposal.

Adjusted Profit

The adjusted profit of an accounting period shall be the profits of that period after the deductions of allowable expenses and any adjustments necessary to exclude the profit or loss attributable to transportation operations which is assessable under Companies Income Tax Act (CITA). The transportation operations referred to here exclude the transportation between the field of production and the place of disposal of oil as referred to in the immediately preceding paragraph.

Where a company engaged in petroleum operations is also involved in the transportation of chargeable oil by ocean going oil-tankers operated by or on behalf of the company from Nigeria to another territory, any profit or loss attributable to such transportation shall be excluded in computing the adjusted profits of the company from its petroleum operations (PPTA Section 14). The profit or loss so excluded shall be taxable under CITA as it is not to be taxed under PPTA. Similar treatment is applicable in respect of the profit or loss accruing to the company which is neither from the petroleum operations source nor incidental thereto. The result accruing to a company that carries out the business of refining of crude oil and all other businesses that are not incidental to petroleum operations is taxable under CITA.

Assessable profit (Section 14)

The assessable profit shall be the adjusted profit of the period after adjusting for Education Tax (Tertiary Education Tax) and the effect of any loss relief available to the company.

Chargeable profits (Section 20)

The chargeable profits shall be the assessable profits, less capital allowances. For this purpose the amount of capital allowances to be deducted is to be restricted to the lower of:

(a) the amount computed; or

(b) a sum equal to eighty-five percent of the assessable profits of the accounting period, less one hundred and seventy percent of the total amount of the deductions allowed as investment tax credit or petroleum investment allowance computed under the second schedule for that period. (Investment Tax Credit if the computation is for a company operating a Production Sharing Contract as provided in the Deep Offshore and Inland Basin Production Sharing Contract Decree 9 of 1999 and petroleum investment allowance in other cases.)

This restriction is in order to ensure that the tax chargeable on the company is not less than fifteen percent of the tax that would have been chargeable had no deduction been made for capital allowances (Subsection 3 of Section 18). Capital allowances that cannot be utilised due to this restriction are to be carried forward to be aggregated with the capital allowances computed for the following accounting periods and subjected to similar restriction in each of those accounting periods.

From the foregoing, the relationship between the terms profits, adjusted profit, assessable profit and chargeable profit can be stated as follows:

Profits for the period	xx
Deduct: allowable expenditures (Section 10) (after necessary adjustment to eliminate transportation operations expenses included)	(x)
Adjusted profit	xx
Less: loss relief (Section 14).	(x)
Assessable profit	xx
Deduct: Education Tax	(x)
Deduct: capital allowances (as restricted) (Section 15).	(x)
Chargeable profit	xx

Artificial Transactions (Section 15)

(a) Where the Revenue Service is of the opinion that :

(i) Any disposition is not in fact given effect to, or

(ii) That any transaction which reduces or would reduce the amount of any tax payable is artificial or fictitious, the Revenue Service may disregard any such disposition or direct that such adjustments shall be made as respects liability to tax as it considers appropriate.

The effect of the Revenue Service's decision will be to counteract the reduction of liability to tax effected, or reduction which would otherwise be effected, by the transaction. The company concerned shall be assessable accordingly. In this subsection, the expression "disposition" includes any trust, grant, covenant, agreement or arrangement.

(b) The following transactions shall be deemed to be artificial or fictitious, namely:

(i) Transactions between persons, one of whom has control over the other .

(ii) Or between persons, both of whom are controlled by some other person; which, in the opinion of the Revenue Service, have not been made on the 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. (Transactions that are not considered to have been carried out at arm's length shall be deemed to be artificial or fictitious).

(c) A company in respect of which any direction is made under this Section shall have a right of appeal in like manner as though such direction were an assessment.

14.7 ALLOWABLE AND NON-ALLOWABLE DEDUCTIONS

Allowable deductions (Section 10)

All outgoings and expenses wholly, exclusively and necessarily incurred, whether within or outside Nigeria, for the purpose of petroleum operations shall be deductible in computing the adjusted profit for any accounting period. Any outgoing or expense that falls under this definition is an allowable deduction irrespective of whether or not such is specifically listed in Section 10 of the Act.

The following are specifically listed as allowable deductions in Section 10 of the Act:

(a) Rents in respect of land or buildings occupied under an oil prospecting licence or an oil mining lease for disturbance of surface rights or for any other similar disturbance:
  (i) All non-productive rents.
  (ii) All royalties in respect of natural gas sold and actually delivered to the Nigerian National Petroleum Corporation (NNPC), or sold to any other buyer or customer or disposed of in any other commercial manner.

(b) All royalties, the liability for which was incurred by the company during that period in respect of crude oil or of casinghead petroleum spirit won in Nigeria. (Prior to 1995, only royalties in respect of exported crude oil were treated as allowable deductions, while that relating to local sales were tax offsets).

(i) All sums by way of customs or excise duty or other-like charges levied in respect of machinery, equipment and other goods used in the company's petroleum operations.

(c) (i) Interest on money borrowed where the Revenue Service is satisfied that the interest was payable on the capital employed in carrying on petroleum operations.
  (ii) 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.

(d) Repairs and or renewals of premises, plant, machinery, implements, utensils, fixtures or articles employed for the purpose of carrying on petroleum operations.

(e) Bad and doubtful debts proved to the satisfaction of the Revenue Service to have become bad or doubtful during the accounting period. The treatment is the same as in normal taxation practice.

(f) (i) Any other expenditure, including tangible costs directly incurred in connection with drilling and appraisal of development well, but excluding an expenditure which is qualifying expenditure for capital allowance purposes and any expense or deduction in respect of a liability which is deductible under any other provision of this Section;
  (ii) Exploration and drilling costs including costs relating to the drilling of the first two appraisal wells in a particular field, including expenditure in respect of cement, casing and well fixtures; and
  (iii) 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 the Second Schedule.

(g) Contribution to approved pension, provident, or other society, scheme or fund.

(h) All sums by way of duty, customs and excise duties, stamp duties, education tax, (amendment in Decree No. 18 of 1998 included education tax with effect from 1/1/96) tax (other than PPT) or any other rate, fee or other like charges.

(i) Such other deductions as may be prescribed by any rule made under the Act.

It should be noted that there are provisions in PPTA similar to those in CITA in respect of waiver or refund of liability or expense. The provisions are applicable to both allowable expenditure and amounts to be deducted from assessable tax in arriving at the chargeable tax.

Where a deduction has been allowed to a company under this Section in respect of any liability of the company and such liability or any part thereof is waived or released, the amount of the deduction or the part thereof corresponding to such part of the liability, shall, for the purposes of subsection (1)(d) of Section 9 of the Act, be treated as income of the company of its accounting period in which such waiver or release was made or given.

Disallowable expenditure (Section 13)

Section 13, subsection 1, of the PPTA states the items that are specifically disallowed from being deducted in arriving at the adjusted profit of an accounting period. These are:

(a) Any disbursements or expenses not wholly and exclusively paid out or expended, or not wholly or exclusively incurred for petroleum operations purposes.

(b) Any capital withdrawn or any sum employed or intended to be employed as capital.

(c) Any capital employed in improvements as distinct from repairs.

(d) Sums recoverable under an insurance or contract of indemnity.

(e) Rent of or cost of repairs to any premises or part of premises not incurred for petroleum operations.

(f) Amounts incurred as income tax, profits tax or other similar tax whether charged within Nigeria or elsewhere.

(g) Depreciation of any kind.

(h) Payment to unapproved provident, savings, widows' and orphans or other society, scheme or fund.

(i) Any custom duty on goods (including articles or any other thing) 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 prices less or equivalent to the cost to the company of the imported goods.

(j) Expenditure for the purchase of information relating to the existence and extent of petroleum deposits.

Subsection 2 of Section 13 deals with interest on inter-group borrowings. Interest on money borrowed and used for petroleum operations purposes shall not be an allowable deduction when either of the following situations applies:

(a) Either the borrowing or lending company has an interest in the other, or

(b) Both have interests in another company either directly or through other companies, or

(c) Both are subsidiaries of another company. For this purpose:

(i) 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.

(ii) An interest means a beneficial interest in issued share capital (by whatever name called); and

(iii) The Revenue Service shall disregard any such interest which in its 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.

It can be seen here that the rules for the determination of control and or holding/ subsidiary relationship are stricter than that applicable under ordinary accountancy practice.

Under Section 10cc, with effect from 1st January 1999 interests on inter-company loans are allowable deductions

Donations

As in the Personal Income Tax Act (PITA) there is no provision in PPTA that is similar to Section 19 of CITA, relating to allowable donations. It is therefore technically correct that any donation made by any company engaged in petroleum operations is not an allowable deduction. However, such expenses can be allowable if the company can prove to the Revenue Service that they are expended wholly, exclusively and necessarily for the company's petroleum operations. Therefore in practice, the Revenue would allow deductions on the same principle as in CITA. However, it is desirable that the Petroleum Profits Tax Act be amended to include specific provisions as to allowable donations in the computation of the profit of an accounting period of a company engaged in petroleum operations.

14.8 TREATMENT OF LOSSES IN PETROLEUM PROFITS TAX COMPUTATIONS

Loss relief (Section 16)

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; and

(b) 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. 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.

14.9 CAPITAL ALLOWANCES

Qualifying expenditure

Qualifying expenditure means capital expenditure incurred in an accounting period, which is:

(a) Incurred on plant, machinery or fixtures – "qualifying plant expenditure"

(b) Incurred on pipelines and storage tanks – "qualifying pipeline and storage expenditure"

(c) Incurred on the construction of buildings, structures or works of a permanent nature – "qualifying building expenditure"

(d) "Qualifying drilling expenditure" – incurred in

- (i) The acquisition of, or rights in or over, petroleum deposits.
- (ii) Searching for or discovering and testing petroleum deposits, or winning access thereto, or
- (iii) The construction of any works or buildings which are likely to be of little or no value when the petroleum operations for which they were constructed ceased to be carried on.

Any sum that can be treated as an allowable expense in accordance with the provision of Section 10 of the Act cannot be treated as qualifying capital expenditure. Qualifying capital expenditure cannot be classified into more than one of the four headings above.

Where qualifying expenditure is incurred by a company before its first accounting period, such shall be deemed to be incurred by it on the first day of its accounting period.

Where the expenditure is incurred in respect of an asset which has been disposed of by the company before the beginning of its first accounting period, then any loss suffered by the company on the disposal of such asset shall be deemed to be qualifying drilling expenditure incurred by the company on that day, and be deemed to have brought into existence an asset owned by the company in use for the purposes of petroleum operations carried on by the company, and any profit realised by the company on such disposal shall be treated as income of the company of its first accounting period for the purposes of subsection (1)(a) of Section 9 of the Act.

Allowances

The allowances are granted at varying rates on the cost of the assets. Before an allowance can be granted, the following conditions must be met:

(i) The capital expenditure must be a qualifying expenditure;

(ii) The qualifying expenditure must be wholly, necessarily and exclusively used for the purposes of petroleum operations carried on by the company; and

(iii) The asset must be owned and used for petroleum operations at the end of the particular accounting period.

An asset is deemed to be in use during a period of temporary disuse.

Fixed assets acquired in an accounting period but put to use in a subsequent accounting period may qualify for capital allowances in the accounting period of purchase.

Petroleum Investment Allowance

It is similar to investment allowance under CITA since it is not taken into account in arriving at the residue of an asset. It was termed Investment Tax Credit prior to the 1999 amendment. With the 1999 amendment, Investment Tax Credit is retained for companies that operate under the Deep Offshore and Inland Basin Production Sharing Contracts Act, 1999, while all others are entitled to Petroleum Investment Allowance. Petroleum Investment Allowance is granted in the accounting period in which the expenditure is incurred. It is granted only once for any particular asset.

Paragraph 5(2) of Schedule 2 states:

"For the purposes of the Act, the Petroleum Investment Allowance shall be added to the annual allowance computed under paragraph 6 of this Schedule and shall be subject to the same rules under the Act."

The treatment is now similar to that of investment allowance under CITA. The amount arrived at is to be added to the annual allowance computed under the PPTA and shall be subject to the same rules. It is not to be deducted from qualifying expenditure in arriving at the residue of expenditure.

(Before the 1999 amendment, the amount computed as Investment Tax Credit was a deduction from tax payable and not a charge against income – see the Section on Tax offsets. This term is now applicable only to companies operating under the Production Sharing Contracts cited above).

Annual allowance

This is granted annually on cost until the residue of the item is 1% of the original cost. The intent is that the amount of any qualifying expenditure is amortised over a period of five years in equal amount except the fifth year when 1% of the amount is retained. The rate is therefore 20% of the cost per annum for each of the first four years and 19% for the fifth year. The 1% of the cost of the asset must be retained in the books until the disposal of the item.

Unlike in Personal Income Tax and Companies Income Tax computations, annual allowance claimable is not pro-rated in Petroleum Profits Tax computations when the accounting period is less than twelve months.

Any asset in respect of which capital allowances have been granted can only be disposed of on the authority of a Certificate of Disposal issued by the Minister or any person authorised by him.

Balancing Allowances and Balancing Charges

The calculation of balancing allowance or charge follows normal taxation principles. The residue of qualifying expenditure is compared with the disposal proceeds to arrive at the balancing allowance or charge.

However, in Petroleum Profits Tax, balancing charge is to be treated as other income to form part of the profits of the company, while balancing allowances are aggregated with other capital allowances. Balancing allowance or charge shall also be made only if immediately prior to the disposal, the asset was in use for the purposes of petroleum operations for which the expenditure was incurred.

Residue of qualifying expenditure (Paragraph 10 of Second Schedule)

The residue of qualifying expenditure, in respect of any asset, at any date, is the total qualifying expenditure incurred, less the total of annual allowances granted to that date in respect of the asset (paragraph 10 of the Second Schedule). It should be noted that the amount for Petroleum Investment Allowance is not to be deducted from qualifying expenditure in arriving at the residue.

Relevant Interest

(a) The owner of a building, structure or works, shall be taken to be the owner of the relevant interest in such building, structure or works.

(b) The expression "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.

(c) 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 interests therein, and one of those interests is an interest which is reversionary on all the others, that interest shall be the relevant interest for the purposes of the Second Schedule.

Sale of Buildings

Where capital expenditure has been incurred on the construction of a building, structure or works and thereafter the relevant interest therein is sold, the company which acquires that interest shall be deemed, except the granting of investment tax credit, to have incurred, on the date when the purchase price became payable, capital expenditure on the construction thereof equal to the price paid by it for such interest or to the original cost of construction, whichever is less:

Provided that:

(a) Where such relevant interest is sold before the building, structure or works has been used, the foregoing provisions of this paragraph shall have effect with respect to such sale with the omission of the words "except the granting of investment tax credit" and the original cost of construction shall be taken to be the amount of the purchase price on such sale;

(b) Where any such relevant interest is sold more than once before the building, structure or works is used, the provisions of subparagraph (a) shall have effect only in relation to the last of those sales.

Meaning of "disposed of" (Paragraph 11)

Subject to any express provision to the contrary, for the purposes of this Schedule

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

  (i) The relevant interest is sold, or

  (ii) 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

(iii) 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

(iv) 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 operation carried on by the owner thereof;

(b) 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;

(c) 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 the 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 monies therefore.

Value of An Asset (Paragraph 12)

(a) The value of an asset at the date of its disposal shall be:

(i) The net proceeds of the sale thereof or of the relevant interest therein, or,

(ii) If it was disposed of without being sold, the amount which, in the opinion of the Revenue Service, 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 so sold.

(b) For the purpose of this paragraph, 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.

(c) So much of subparagraph (1) as relates to the circumstances for determining the value of an asset by reference to the disposal of such asset other than by way of sale shall have effect:

(i) In relation to any asset or the relevant interest therein disposed of not being by way of bargain made at arm's length, or

(ii) Where the sale is between persons who are related to each other or between persons both of whom are controlled by some other person or one of whom has control over the other.

Apportionment (Paragraph 13)

(a) Any reference in this paragraph to the disposal, sale or purchase of any asset includes a reference to the disposal, sale or purchase of that asset, as the case may be, together with any other asset, whether or not qualifying expenditure has been incurred on such last-mentioned asset, and, where an asset is disposed of, sold, or purchased together with another asset, so much of the value of the assets as, on a just apportionment, is properly attributable to the first-mentioned asset shall, for the purposes of this Schedule, be deemed to be the value of, or the price paid for, that asset, as the case may be. For the purposes of this subparagraph, all the assets which are purchased or disposed of in pursuance of one bargain shall be deemed to be purchased or disposed of together, notwithstanding that separate prices are or purported to be agreed for each of those assets or that they are or purported to be separate purchases or disposal of those assets.

(b) The provisions of subparagraph (1) of this paragraph, shall apply, with any necessary modifications, to the sale or purchase of the relevant interest in any asset together with any other asset or relevant interest in any other asset.

Part of An Asset (Paragraph 14)

Any reference in this paragraph to any asset shall be construed whenever necessary as including a reference to a part of any asset (including an undivided part of that asset in the case of joint interests therein) and when so construed any necessary apportionment shall be made as may, in the opinion of the Revenue Service Board, be just and reasonable.

Extension of meaning of "In Use" (Paragraph 15)

(a) For the purposes of this paragraph, an asset shall be deemed to be in use during a period of temporary disuse.

(b) For the purposes of paragraphs 5, 6 and 7 of the second schedule:

    (i) An asset in respect of which qualifying expenditure has been incurred by the owner for the purposes of petroleum operations carried on by him shall be deemed to be in use for the purposes of such operations, between the dates hereinafter mentioned, where the Revenue Service is of the opinion that the first use to which the asset will be put by that owner incurring such expenditure will be for the purposes of such operations;

    (ii) The said dates shall be taken to be the date on which such expenditure was incurred and the date on which the asset is in fact first put to use:

Provided that where any allowances have been given in consequence of this subparagraph (2) of this paragraph and the first use to which such asset is put is not for the purposes of such operations, all such additional assessments shall be made as may be necessary to counteract the benefit obtained from the giving of any such allowances.

Exclusion of Certain Expenditure (Paragraph 16)

(a) Subject to the express provisions of this paragraph, where any company has incurred expenditure which is allowed to be deducted under any provision (other than a provision of this Schedule) of the Act, such expenditure shall not be or be treated as qualifying expenditure.

(b) Where any company has incurred expenditure upon any ocean going oil-tanker plying between Nigeria and any other territory that expenditure shall not be treated as qualifying expenditure.

Assets Used or Expenditure Incurred Partly for the purpose of Petroleum Operations (Paragraph 17)

(a) The following provisions of this paragraph shall apply where either or both of the following conditions apply with respect to any asset:
   (i) The owner of the asset has incurred in respect thereof qualifying expenditure partly for the purposes of petroleum operations carried on by him and partly for other purposes;
   (ii) The asset in respect of which qualifying expenditure has been incurred by the owner thereof is used partly for the purposes of petroleum operations carried on by such owner and partly for other purposes.

(b) Any allowances which would be due or any balancing charges which would be treated as income if both such expenditure were incurred wholly and exclusively for the purposes of such petroleum operations and such asset were used wholly and exclusively for the purposes of such operations shall be computed in accordance with the provisions of this Schedule.

(c) So much of the allowances and charges computed in accordance with the provisions of subparagraph (2) of this paragraph shall be due or shall be so treated, as the case may be, as in the opinion of the Revenue Service is just and reasonable having regard to all the circumstances and to the provisions of this Schedule.

Disposal without change of Ownership (Paragraph 18)

Where an asset in respect of which qualifying expenditure has been incurred by the owner thereof has been disposed of in such circumstances that such owner remains the owner thereof, then, for the purposes of determining whether

and, if so, in what amount, any annual or balancing allowance or balancing charge shall be made to or on such owner in respect of his use of that asset after the date of such disposal:

(a) Qualifying expenditure incurred by such owner in respect of such asset prior to the date of such disposal shall be left out of account; but

(b) Such owner shall be deemed to have bought such asset immediately after such disposal for a price equal to the residue of such qualifying expenditure at the date of such disposal, increased by the amount of any balancing charge or decreased by the amount of any balancing allowance made as a result of such disposal –

Fixed Assets Acquired Under Hire Purchase

Fixed assets acquired under hire purchase agreements will qualify for capital allowances only to the extent of the amount of the instalments paid during the accounting period.

The interest element of the installmental payments is also to be eliminated from the amount to be capitalised: this will be an allowable deduction as interest on money borrowed and used for the purposes of petroleum operations. This is the same treatment applicable to companies assessable to tax under the provisions of the Companies Income Tax Act.

Capital Allowance Rates

(a) **Petroleum Investment Allowance**

Qualifying expenditure in respect of

(i)	On shore operations	5%
(ii)	Operations in territorial waters and continental shelf areas up to and including 100 metres of water depth	10%
(iii)	Operations in territorial waters and continental shelf areas in water depth between 100 metres and 200 metres	15%
(iv)	Operations in territorial waters and continental shelf areas beyond 200 metres of water depth	20%

Investment Tax Credit

(i)	Deep Offshore and Inland Basin Production Sharing Contracts	50%

(b) **Annual Allowance**

1st year	20%
2nd year	20%
3rd year	20%
4th year	20%
5th year	19%
6th year and after	19%

14.10 ASCERTAINMENT OF ASSESSABLE TAX AND CHARGEABLE TAX

Assessable Tax – Rates of Tax

(a) The assessable tax for any accounting period of a company shall be an amount equal to eighty-five percent (85%) of the chargeable profits of that period (Section 21(1). (This is applicable to crude export sales alone)

(b) Where a company has not yet commenced to make a sale or bulk disposal of chargeable oil under a programme of continuous production and sales as at 1 April 1977, its assessable tax for any accounting period during which it has not fully amortized all pre-production capitalised expenditure due t it less the 1% amount to be retained in the book, shall be 65.75% of the chargeable profits for that period.

(c) For local crude sales, the rate applicable is 65.75%. Although this is not in PPTA, it is one of the concessions available to the oil companies through the side letters.

(d) For natural gas sales, the tax rate is 40%. This is also not in PPTA. It is granted in a similar manner to the special rate of 65.75% for crude sold locally.

(e) In respect of companies operating the Deep Offshore and Inland Basin Production Sharing Contracts as contained in Decree 9 of 1999, the applicable rate is 50% of chargeable profits.

Chargeable tax (Section 22)

A new Section 20 introduced in the 1999 amendment is as follows:

(a) A crude oil producing company which executed a Production Sharing Contract with the Nigerian National Petroleum Corporation in 1993 shall, throughout the duration of the Production Sharing Contract, be entitled to claim an investment tax credit as an offset against tax in accordance with the provisions of the Production Sharing Contract.

(b) The investment tax credit rate applicable to the contract area shall be fifty per cent flat rate of chargeable profit for the duration of the Production Sharing Contract.

(c) In computing the tax payable, the investment tax credit shall be applicable in full to petroleum operations in the contract area such that the chargeable tax is the amount of the assessable tax less the investment tax credit.

(d) The chargeable tax computed under subsection (3) of this Section shall be split between the Nigerian National Petroleum Corporation and the crude oil producing company in accordance with the proportion of the percentage of profit oil split.

(e) In this Section 'contract area" means the contract area as defined in the Production Sharing Contract;

"Production Sharing Contract" has the meaning assigned to it in the Deep Offshore and Inland Basin Production Sharing Contracts Decree 1999."

It is necessary to note apparent drafting errors in this new Section 22: In subsection 1, "investment tax credit allowance" should read 'investment tax credit'. In subsection 2, the rate of investment tax credit stated as "fifty per cent flat rate of chargeable profit" should read 50% of qualifying capital expenditure! Investment tax credit cannot be granted as a percentage of chargeable profits, it has to be as a percentage of the relevant additions to qualifying expenditure in the accounting period under consideration.

What can be extracted from the new Section 22 can, therefore, be summarised thus:

(a) It is applicable only to companies operating under the Production Sharing Contracts.

(b) Such companies are entitled to investment tax credit as a tax offset. The chargeable tax is the amount of the assessable tax less the investment tax credit. Investment Tax Credit continues to be a tax offset for those petroleum producing companies operating the Production Sharing Contracts.

(c) The investment tax credit is 50% of qualifying capital expenditure incurred in the accounting period under consideration.

(d) The rate of 50% is applicable for each accounting period throughout the duration of each Production Sharing Contract.

(e) The burden of the chargeable tax is on Nigerian National Petroleum Corporation and the other party (parties) to the particular Production Sharing Contract shared according to proportion of the percentage of profit oil split.

Tax Offsets

In accordance with former Section 17 PPTA, the following shall be deducted from assessable tax to arrive at the chargeable tax:

(a) Royalties in respect of chargeable oil won and locally disposed of during that period to the extent that those royalties are not deductible under Section 10(1) of the Act in computing the adjusted profit of the company.

(b) Non-productive rents expenditure.

(c) Investment tax credit on qualifying expenditure.

(d) Custom or excise duty or other like charges levied in respect of items essential for use in the company's petroleum operations.

These were referred to as tax offsets, that is they were to be set off against the assessable tax computed. With the various amendments to the PPTA and the

promulgation of the Deep Offshore and Inland Basin Production Sharing Contracts Decree 1999, all the items above except (c) are now Section 10 tax deductible. They are no longer to be treated as tax offsets.

In respect of item (c), Investment tax credit on qualifying expenditure, this is now only applicable to companies operating under the Deep Offshore and Inland Basin Production Sharing Contracts Decree 1999. It is still to be treated as tax offset in the tax computations of such companies for all Production Sharing Contract signed on or before 1 July 1998. (The Finance Miscellaneous Taxation Provision Decree, Decree 30, 1999, limits Investment Tax Credits to Production Sharing Contract (PSC) signed with NNPC before 1993. This apparent conflict with the relevant provision of the PSC Decree has to be ignored!). However, it is no longer applicable in respect of other petroleum companies that are not operating under the Deep Offshore and Inland Basin Production Sharing Contracts Decree 1999. These companies are entitled to Petroleum Investment Allowance which is treated in the same way as an annual allowance is treated in Petroleum Profits Tax Computations.

Additional Chargeable Tax (Section 23)

In Section 9 of the PPTA, the calculation of the profits of an accounting period is expected to be based on the actual proceeds of sale of crude oil export as made by the company. For instance, if the actual market selling price of one barrel of crude oil is $40 and a company exports its own crude at say $10 per barrel, on the basis of the provision of Section 9 of the PPTA, the company's accounting profit for that accounting year would be calculated on the basis of the $10 per barrel export sales proceeds plus the other sales. In such a situation, it is not likely that the accounts of the company would show a profit, super profits being made by its associates overseas to which the crude would have been sold at very low selling prices.

Section 21 was introduced partly for the purpose of discouraging such abuse and to ensure that sales of crude oil made by companies engaged in petroleum operations are made at prices that would align with the market prices.

The provision of Section 23 is to the following effect:

(a) Actual proceeds of sales of crude oil exported are computed, applying the actual selling prices. The resultant figure is used in the computation of the accounting profit and chargeable tax for the accounting period; and

(b) A sort of notional sales proceed of crude oil exported (what the sales proceed could have been) is also computed, applying what is referred to as the posted prices in place of the actual selling prices by the company. The amount arrived at would also be used in the computation of the profits as well as the chargeable tax of the accounting period of the company.

The chargeable tax arrived at by applying the posted prices is compared with that arrived at by applying the actual export sales prices and the higher of the two shall be the final chargeable tax of the company for that accounting period. Thus, if the chargeable tax arrived at by applying the posted prices is higher, the company shall be liable to pay an additional amount of chargeable tax for that period equal to the difference between the two amounts.

The whole of any additional chargeable tax payable by a company by virtue of this provision for any accounting period shall be payable concurrently with the final installment of the chargeable tax payable for that period.

ILLUSTRATION 14.1

The chargeable tax of Danak Oil Producing Limited, a company engaged in petroleum operations in Nigeria, was computed to be ₦475,500,000, on the basis of the actual sales prices of crude oil exported by the company for the 2008 accounting year. On the basis of the posted prices applicable during the accounting year the chargeable tax was computed to be ₦587,600,000. What is the additional tax payable and when should it be paid?

SUGGESTED SOLUTION 14.1

The additional tax payable is as follows:	₦
Chargeable tax on the basis of the posted prices	587,600,000
Less: Chargeable tax on the basis of actual prices	
of exported crude	475,500,000
Additional tax payable	**112,100,000**

The additional tax of ₦112,100,000 is payable together with the final installment of the chargeable tax for the 2008 accounting year within a period of twenty-one days from the date of service of the notice of assessment of tax for the accounting period.

The above shows what should be the treatment in accordance with the provisions of PPTA. However, a short cut approach that is being used in tax computations is to replace the sales prices with the posted prices (if posted prices are higher, frequently posted prices will be higher) with regards to crude oil exported, in the calculation of fiscal value of chargeable oil sold. This will automatically take care of the additional chargeable tax payable.

14.11 CONCEPTS AND COMPUTATIONS OF POSTED PRICES

Posted price

Posted price in relation to any crude oil exported from Nigeria by a company means the price f.o.b. at the Nigerian port of export for crude oil of the gravity and quality in question which is from time to time established by the company, after agreement with the Government of Nigeria as to the procedure to be followed for the purpose as its posted price for Nigerian crude oil of that gravity and quality (Section 23(5).

Every posted price established as aforesaid must bear a fair and reasonable relationship:

(a) To the established posted prices of Nigerian crude oils of comparable quality and gravity, if any; or

(b) If there are no such established posted prices for such Nigerian crude oils, to the posted prices at main international trading export centres for crude oil of comparable quality and gravity, due regard being had in either case to freight differentials and all other relevant factors.

The posted price for each type of crude oil stream is advised by the Organisation of Petroleum Exporting Countries (OPEC). With the information from OPEC, each member country sets the posted price, taking into account the sulphur content, freight differentials and other local factors.

The measurement unit for crude oil for posted prices purposes is "degrees API". API (American Petroleum Institute) is a unit of specific gravity measurement approved by the American Petroleum Institute. Posted prices are quoted in the United States dollars per barrel at a specified API for each crude oil stream. For every degree of API above the Standard API for the crude oil stream, the posted price is increased by US$0.03 per barrel. For every degree API below the Standard, the posted price is decreased by US$0.03 per barrel. Nigeria's crude is of a maximum API of 400.

ILLUSTRATION 14-2

The crude oil exported from Nigeria by Marina Oil Limited in December 2008 was 30^0 API. The posted price advised by the Nigerian National Petroleum Corporation (NNPC) is US$45.50 for the crude stream with a Standard API of 35^0. What is the posted price for the crude oil exported by Marina Oil Limited?

SUGGESTED SOLUTION 14-2

		$
Posted price as advised by NNPC at 35^0 API		45.50
Standard API	35^0	
Gravity of oil exported	(30^0)	
Decrease in API from standard	5^0	
Reduction in posted price	5^0 x $0.03	
(0.15)		
Posted price for the crude oil exported by the company		45.35

14.12 BUSINESS SOLD OR TRANSFERRED (SECTION 17)

Consider the following situation:

(a) A business is sold by a Nigerian company to another Nigerian company for the purposes of better organisation; or

(b) There is a transfer of the management of a business to Nigeria;

(c) The assets employed in the business in (a) and/or (b) above is also sold;

(d) The Revenue Service is satisfied that one of those companies has control over the other or that both are controlled by some other person or are members of a recognised group of companies, then the following shall be applicable:

(i) If the first sale or bulk disposal of chargeable oil by the selling company has occurred, but has not occurred in case of the acquiring company:

- The first accounting period of the acquiring company shall be a period of twelve months from the date on, or within the calendar month in, which the sale of the business takes place as may be selected by the Nigerian company. This will be at the discretion of the Revenue Service and through a directive to the company to select the period. Such selection is subject to the approval of the Revenue Service.
- Subsequent accounting periods shall also be decided by reference to this first accounting period, that is, in this situation, the company's accounting period may not necessarily be from 1 January to 31 December.

(ii) For capital allowance purposes, the asset sold shall be deemed to have been sold for an amount equal to the residue of the qualifying expenditure of the asset on the day following the date of sale.

(iii) Initial allowance cannot be claimed on the asset by the acquiring company and the company would be deemed to have received all capital allowances granted to the selling company up to the date of sale.

Nigerian company as used in this Section means any company incorporated under the Companies and Allied Matters Act, 2004 (as updated) or any enactment replaced by that Act.

14.13 RECONSTITUTED COMPANY (SECTION 18)

Where:

(a) A company (the reconstituted company) is incorporated under the Companies and Allied Matters Act 2004 (as updated);

(b) The reconstituted company is to carry on any trade or business of petroleum operations previously carried on in Nigeria by a foreign company;

(c) Assets employed in Nigeria by the foreign company in that trade or business vest in the reconstituted company; and

(d) If the Revenue Service is satisfied that the trade or business carried on by the reconstituted company immediately after incorporation is not substantially different in nature from the trade or business previously carried on in Nigeria by the foreign company;

Then the following shall be applicable:

(a) If as respects the trade or business previously carried on in Nigeria by the foreign company the first sale of or bulk disposal of chargeable oil by or on behalf of the foreign company has occurred on or before the date on which the reconstituted company is incorporated-

(i) The first accounting period of the reconstituted company shall be the period of twelve months commencing on the date on which that company is incorporated, or commencing on such date within the calendar month in which the company is incorporated as may be selected by the company with the approval of the Revenue Service, and

(ii) An accounting period as respects the reconstituted company shall be a period of twelve months commencing on such date within the calendar month in which the reconstituted company is incorporated as may be selected by the company with the approval of the Revenue Service. The definition of "accounting period" shall be construed accordingly.

(b) The assets so vested in the reconstituted company hall be deemed to have been sold to it, on the day of its incorporation, for an amount equal to the residue of the qualifying expenditure thereon on the day following the day on which the trade or business previously carried on in Nigeria by the foreign company ceased;

(c) The reconstituted company shall not be entitled to any initial allowances as respects those assets, and shall be deemed to have received all allowances given to the foreign company in respect of those assets.

(d) In addition any unrelieved loss of the foreign company shall be deemed to be a loss incurred by the reconstituted company in its trade or business during its first accounting period and will be eligible for relief accordingly. An application for the relief of such loss must be submitted to the Chief Petroleum Engineer with a copy to the Revenue Service within two years after the incorporation of the reconstituted company.

In this Section, "foreign company" means a company incorporated outside Nigeria before 18 November 1968, and having on that date an established place of business in Nigeria.

Revenue Service's Power to Call for Returns

For the purposes of Sections 17 of the Act, the Revenue Service may by notice require any person (including a company to which any assets are sold or transferred, or in which any assets have vested in pursuance of Companies and Allied Matters Act, to complete and deliver to the Revenue Service any returns specified in the notice or any such information as the Revenue Service may require about the assets; and it shall be the duty of that person to comply with the requirements of any such notice within the period specified in the notice, not being a period of less than twenty-one days from the service thereof. (Section 17).

14.14 ACCOUNTS AND PARTICULARS

Accounts and tax computation (Section 28)

For each accounting period the company shall make up accounts of its profits or losses arising from petroleum operations in that period as well as the following particulars:

(a) Computations of its estimated adjusted profit or loss and of its estimated assessable profits of that period;

(b) Capital allowances computation schedules showing –

   (i) the residues of its assets at the end of that period,

   (ii) all qualifying petroleum expenditure incurred by it in that period,

   (iii) the values of any assets disposed of in the period,

   (iv) the capital allowances due to it for the period.

(c) Computation of its estimated chargeable profits of the period;

(d) A statement of other sums, deductible under Section 20 (items deductible from assessable tax to arrive at chargeable tax), the liabilities for which were incurred during that period;
(e) A statement of all amounts repaid, refunded, waived or released during that period in respect of amounts deducted under Section 20 in prior periods;
(f) A computation of its estimated tax for the period.

At the end of the accounting period, the actual tax payable will be computed. The tax computation based on the audited accounts of the company will be submitted to the tax office accompanied with all required documents.

Time limit for submission

A copy of the audited accounts of the company together with copies of all the particulars listed above are to be delivered to the Revenue Service within five months after the expiration of the company's accounting period. Such documents must be signed by a duly authorised officer of the company to the effect that they are true and complete.

The Revenue Service may grant extension of the time limit if some good reason is shown by the company to the satisfaction of the Revenue Service why the company cannot comply with the deadline.

Returns of Estimated Tax (Section 31)

Within two months of the commencement of each accounting period, the company should submit to the Revenue Service, a return of its estimated tax for the accounting period.

A revised estimated tax for the period will need to be submitted as well at any time during the accounting period that the company is aware that the original estimate requires revision.

The estimate will be replaced with the actual at the end of the company's accounting period after the statutory audit of its financial statements is concluded.

Unit of Currency

All income tax computations made under Section 30 and Section 33 of the PPTA shall be made in the currency in which the transaction was effected. Accordingly and notwithstanding anything to the contrary in any law, any assessment made under Section 35(1) of the PPTA shall also be made in the currency in which the computation giving rise to the assessment was made. (Section 37A1 and A2).

14.15 ASSESSMENT AND APPEAL PROCEDURES (SECTION 35)

Assessments

(a) The Revenue Service shall proceed to assess every company for the tax for any accounting period of the company as soon as possible after the expiration of the time allowed to such company for the delivery of the accounts and particulars provided for in Section 30 of the Act.

(b) Where a company has delivered accounts and particulars for any accounting period of the company, the Revenue Service may:

  (i) Accept the same and make an assessment accordingly; or

  (ii) Refuse to accept the same and proceed as provided in subsection (3) of this Section upon any failure as therein mentioned with attendant consequences.

Best Of Judgment (BOJ) Assessment

Where, for any accounting period of a company, the company has

(a) Failed to deliver accounts and particulars provided for in Section 30 of the Act within the time limited by that Section or

(b) Failed to comply with any notice given to it under the provisions of Section 31 or 32 of the Act within the time specified in such notice, or within any extended time provided for in Section 34 of the Act; and

(c) The Revenue Service is of the opinion that such company is liable to pay tax.

The Revenue Service may estimate the amount of the tax to be paid by such company for that accounting period and make an assessment accordingly (BOJ assessment).

Such assessment shall not affect any liability otherwise incurred by such company by reason of its failure or neglect to deliver such accounts and particulars or to comply with such notices; and nothing in this subsection shall affect the right of the Revenue Service to make any additional assessment under the provisions of Section 36 of the Act.

Additional Assessments (Section 36)

(a) If the Revenue Service discovers or is of the opinion at any time that, with respect to any company liable to tax,

  (i) Tax has not been charged and assessed upon the company or

  (ii) Has been charged and assessed upon the company at a less amount than that which ought to have been charged and assessed for any accounting period of the company,

  The Revenue Service may within six years after the expiration of that accounting period and as often as may be necessary,

- Assess such company to tax for that accounting period at such amount or additional amount as in the opinion of the Revenue Service ought to have been charged and assessed, and
- May make any consequential revision of the tax charged or to be charged for any subsequent accounting period of the company (Section 36 (1)).

(b) Where a revision under subsection(1) of this Section results in higher amount of tax to be charged than has been charged or would otherwise be charged, an additional assessment or an assessment for any such subsequent accounting period shall be made accordingly. The provisions of the Act as to notice of assessment, objection, appeal and other proceedings under the Act shall apply to any such assessment or additional assessment and to the tax charged thereunder. (Section 36(2))

(c) For the purpose of computing the amount or the additional amount of tax for any accounting period of a company which ought to have been charged, all relevant facts consistent with subsection (3) of Section 40 of the Act shall be taken into account even though not known when any previous assessment or additional assessment on the company for that accounting period was being made or could have been made: Section 34(3)

(d) Notwithstanding the other provisions of this Section, where any form of fraud, willful default or neglect has been committed by or on behalf of any company in connection with any tax imposed under the Act, the Revenue Service may, at any time and as often as may be necessary, assess the company on such amount as may be necessary for the purpose of recovering any loss of tax attributable to the fraud, willful default or neglect. (Section 34(4)).

Form of Assessment (Section 37)

(a) Assessments of tax shall be made in such form and in such manner as the Revenue Service shall authorise and shall contain:
  - (i) the names and addresses of the companies assessed to tax or
  - (ii) of the persons in whose names any companies (with the names of such companies) have been assessed to tax,
  - (iii) the particular accounting period
  - (iv) the amount of the chargeable profits for the period
  - (v) the amount of the assessable tax for the period
  - (vi) the amount of the chargeable tax for the period. (Section 35(1))

(b) When any assessment requires to be amended or revised, a form of amended or revised assessment shall be made in a manner similar to that in which the original of that assessment was made under subsection (1) of this Section but showing the amended or revised amount of the chargeable profits, assessable tax and chargeable tax. (Section 35(2))

(c) A copy of each assessment, and of each amended or revised assessment shall be filed in a list which shall constitute the Assessment List for the purpose of the Act (Section 35(3)).

Notices of Assessment

The Revenue Service shall cause to be served personally on or sent by registered post to each person whose name appears on an assessment in the Assessment List, a notice of assessment. The notice of assessment shall state:

(a) The company's accounting period;
(b) The amount of its chargeable profits;
(c) The assessable tax;
(d) The chargeable tax charged and assessed upon the company;
(e) The place at which payment of the tax should be made; and
(f) Informing such company of its rights under subsection (2) of this Section (Section 36(1)).

Objection

If any person in whose name an assessment was made in accordance with the provisions of the Act disputes the assessment, that person may apply to the Revenue Service, by notice of objection

(a) The notice of objection has to be given in writing.
(b) The taxpayer will ask the Revenue Service to review and revise the assessment.
(c) The application shall be made within twenty one days from the date of service of the notice of assessment.
(d) It shall state the amount of chargeable profits of the company for the accounting period in respect of which the assessment is made.
(e) It shall state the amount of the assessable tax.
(f) It shall also state the tax which such person claims should be stated on the notice of assessment (Section 38(2).

The Revenue Service, upon being satisfied that owing to absence from Nigeria, sickness or other reasonable cause, the person in whose name the assessment was made was prevented from making the application within such period of twenty-one days shall, extend the period as may be reasonable in the circumstances (Section 38(3)).

After receipt of notice of objection referred to in subsection (2) of this Section the Revenue Service may within such time and at such place as the Revenue Service shall specify, require the person giving the notice of objection to furnish such particulars as the Revenue Service may deem necessary, and may by notice within such time and at such place as the Revenue Service shall specify, require any person to give evidence orally or in writing respecting any matters necessary for the ascertainment of the tax payable, and the Revenue Service may require such evidence if given orally to be given on oath or if given in writing to be given by affidavit (Section 38(4)).

Amended Assessment

In the event of any person assessed who has objected to an assessment made upon him with respect to the amount of tax liable on assessment, such assessment shall be amended accordingly, and notice of the tax payable shall be served upon such person (Section 38(5)).

Notice of Refusal to Amend

If an applicant for revision under the provisions of subsection (2) of this Section fails to agree with the Revenue Service the amount of the tax, the Revenue Service shall give such applicant notice of refusal to amend the assessment as desired by such applicant, and may revise the assessment to such amount as the Revenue Service may determine and give such applicant notice of the revised assessment and of the tax payable together with notice of refusal to amend the revised assessment and, wherever requisite, any reference in the Act to an assessment or to an additional assessment shall be treated as a reference to an assessment or to an additional assessment as revised under the provisions of this subsection (Section 38(6)).

Errors in Assessment Notices

No assessment, warrant or other proceeding, purporting to be made in accordance with the provisions of the Act shall be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of a mistake, defect or omission therein, if the same is in substance and effect in conformity with or according to the intent and meaning of the Act or any Act amending the same, and if the company assessed or intended to be assessed or affected thereby is designated therein according to common intent and understanding (Section 39(1)).

An assessment shall not be impeached or affected

(a) By reason of a mistake therein as to:
    (i) The name of a company liable or of a person in whose name a company is assessed, or
    (ii) The amount of the tax;
(b) By reason of any variance between the assessment and the notice thereof, if in cases of assessment, the notice thereof be duly served on the

company intended to be assessed or on the person in whose name the assessment was to be made on a company, and such notice contains, in substance and effect, the particulars on which the assessment is made (Section 39(2)).

Appeals from Decisions of the Service

(a) A person aggrieved by an assessment or demand notice made upon him by the service of 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.

(b) An appeal 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.

(c) Where a notice of appeal is not given by the appellant the period specified, the assessment or demand notices shall become final and conclusive and the service may charge interest 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

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

(b) Where 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.

(c) 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.

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

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

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

(g) 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:

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

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

(iii) 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 assessment under appeal, equal to 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.

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

(v) 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 30days of such decision.

Where upon the hearing or an appeal

(i) No accounts, books or records relating to profit were produced by or on behalf of the appellant

(ii) 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

(iii) 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

(iv) 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

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

(b) 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.

(c) 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

(a) 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.

(b) A notice of appeal shall be filed and set out all the grounds of law on which the appellant's case is based.

(c) 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 to the Secretary within 30days after the date on which such decision was given.

(d) 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.

(e) 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 Representative

(a) 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.

(b) 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

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

(b) 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

(c) 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

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

Costs
Each party to an appeal shall bear its own cost

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

14.16 PERSONS CHARGEABLE
Section 24(1) of the Act makes it an offence for any person (other than a company) to engage in petroleum operations in any form with a view to sharing the profits arising from such operations. It is therefore certain that PPT is payable only by companies.

Where companies are engaged in petroleum operations in partnership or in a joint venture under any scheme or arrangement, the Minister may make rules modifying the provisions of the PPTA for the ascertainment of the tax to be charged and assessed upon each of the companies involved. The effect of any such rules shall not be to impose a greater burden of tax on any company engaged in such partnership or joint venture than the proportion of its share of the benefits therefrom.

Non-resident company (Section 25)
A non-resident company engaged in petroleum operations shall be assessable and chargeable to tax as if it were resident either, directly or in the name of its manager, or in the name of any other person who is resident in Nigeria and employed in the management of the petroleum operations of the company.

The person in whose name a non-resident company is assessable and chargeable to tax shall be answerable –

(a) for all matters required to be done by virtue of the Act for the assessment of the tax as might be required to be done by such non-resident company if it were resident in Nigeria, and

(b) for paying any tax assessed and charged in the name of such person.

Resident company (Section 26)
The manager or any principal officer in Nigeria of every company engaged in petroleum operations shall be answerable for doing all such acts as are required to be done by virtue of the Act for the assessment and charge to tax of such company and for payment of such tax.

Company in receivership or liquidation (Section 27)
A company being wound up or under a receiver may be assessed and charged to tax, in the name of the liquidator or receiver or any agent of the liquidator or receiver, for any accounting period whether before, during or after the date of

appointment of the liquidator or receiver. Any such liquidator, receiver or agent shall be answerable for doing all such acts as are required to be done by virtue of the Act, for the assessment and charge to tax of such company and for payment of the tax.

The distribution of the assets of the company to the shareholders or debenture holders thereof should not be made unless adequate provision has been made for the payment in full of any tax which may be found payable by the company.

14.17 COLLECTION AND REPAYMENT OF TAX

Payment dates

The tax for any accounting period shall be payable in twelve equal monthly instalments together with a final instalment. The first monthly installment is due and payable not later than the third month of the accounting period. The amount payable is one-twelfth of the estimated tax for the year. A "returns of estimated tax" is expected to have been made by the company to the Revenue Service in accordance with the provision of Section 33(1) and should have been filed not later than two months from the commencement of the accounting period. It is the estimated tax on such returns that will be divided into twelve for the purpose of the monthly instalments payable.

Where the accounting period is less than one year, the amount payable shall be proportional to the total number of months in the period. Subsequent monthly instalments are due and payable not later than the last day of the month in question. The final instalment is due and payable within twenty-one days after the service of the notice of assessment of tax for the accounting period. The amount of this final instalment is the amount of tax assessed for the accounting period less the total of the amounts paid by the twelve instalments. The payment dates in respect of each accounting period are summarised below:

Petroleum Profits Tax payment dates

Instalment		Payment dates
1st	Due and payable by	31 March of the accounting period
2nd	Due and payable by	30 April of the accounting period
3rd	Due and payable by	31 May of the accounting period
4th	Due and payable by	30 June of the accounting period
5th	Due and payable by	31 July of the accounting period
6th	Due and payable by	31 August of the accounting period
7th	Due and payable by	30 September of the accounting period
8th	Due and payable by	31 October of the accounting period
9th	Due and payable by	30 November of the accounting period
10th	Due and payable by	31 December of the accounting period

11th	Due and payable b	31 January of the next accounting period
12th	Due and payable by	28 or 29 February of the next accounting period

Tax subject to objection or appeal

Where any tax is a subject of an objection or appeal, that tax shall be held over, pending the result of the objection or appeal. Nevertheless the Revenue Service may enforce payment of that portion of the tax (if any) which is not in dispute.

The tax outstanding under the assessment as determined on such objection or appeal as the case may be is payable as follows:

(a) The amount of the tax held over is payable immediately; and

(b) While any additional sum to the amount held over is payable within one month from the date of service of the notification of the tax payable

Penalty

If any installment of tax due and payable is not paid within the appropriate time limit referred to above, a penalty of 5% of the amount of the installment shall be added and become payable. (Note that the rate is stated as 5% in the Act, it is not stated as "per annum" as the case is with the equivalent penalty applicable in CITA and PITA). A demand note will thereafter be served on the company and payment is to be made (of the tax and the penalty) within one month of the date of the service of the demand note.

Any company who without lawful justification or excuse, the proof of which is on the company, fails to pay the tax within this period of one month shall be guilty of an offence. The Revenue Service may, for any good cause shown, remit the whole or any part of the penalty.

Error or mistake claim

The provisions in Section 49 of PPTA with regard to error or mistake claim are as follows:

(a) If any person who has paid tax for any accounting period alleges that, assessment made upon him or in his name for that period, was excessive by reason of some error or mistake in the accounts, particulars or other written information supplied by him to the Revenue Service for the purpose of the assessment, such person may make an application in writing to the Revenue Service for relief. Such an application can be made at any time not later than six years after the end of the accounting period in respect of which the assessment was made.

(b) On receiving such application the Revenue Service shall inquire into the matter and subject to the provisions of this Section shall, by way of repayment of tax, give such relief in respect of the error or mistake as appears to the Revenue Service to be reasonable and just.

(c) No relief shall be given if such accounts, particulars or information was in fact made or given on the basis or in accordance with the practice of the Revenue Service generally prevailing at the time when such accounts, particulars or information was made or given. In other words an error in the basis of assessment through the application of a practice then prevailing is not a ground for relief.

(d) In determining any application under this Section the Revenue Service shall have regard to all the relevant circumstances of the case, and in particular shall consider whether the granting of relief would result in the exclusion from charge to tax of any part of the chargeable profits of the applicant, and for this purpose the Revenue Service may take into consideration the liability of the applicant and assessments made upon him in respect of other years.

(e) No appeal shall lie from a determination of the Revenue Service under this Section, which determination shall be final and conclusive.

Repayment of tax

The Revenue Service shall give a certificate of the amount of any tax to be repaid under any of the provisions of the PPTA or under any order of a court of competent jurisdiction. Upon the receipt of the certificate, the Accountant General of the Federation shall cause repayment to be made in conformity with the certificate.

Repayment claim must be made in writing within six years next after the end of the accounting period to which it relates. If the Revenue Service disputes any such claim, a notice of refusal to admit the claim shall be given to the claimant and the provisions of the Act with regard to objections and appeals shall apply with any necessary modifications.

14.18 DEDUCTION OF TAX AT SOURCE

Similar to the provision of Section 81 of CITA, Section 56 has been inserted in PPTA by Decree No. 21 of 1991. The Section provides for deduction of withholding tax from payments due to any company, partnership, or person, (whether or not resident in Nigeria) who provides petroleum operations services and related activities to a company carrying on petroleum operations in Nigeria.

The services and activities affected and the applicable rates are:

Nature of service or activity	Rates of withholding tax	
	Companies	Individuals
All aspects of building construction and related activities	5%	5%
All types of contracts other than sale and purchase of goods and property	5%	5%

Nature of service or activity	Rates of withholding tax	
	Companies	Individuals
Consultancy and professional services	10%	5%
Management services	10%	5%
Technical services	10%	5%
Commissions	10%	5%

Other relevant provisions of the subsidiary legislation are:

(a) The deductions are not and should not be regarded as additional cost of contracts or services rendered and should therefore not be built into costs. They are deductions in lieu of tax.

(b) A person who had deducted tax from such payments shall issue a receipt for the amount of tax deducted and a statement showing details prescribed in paragraph 4 below.

(c) Such person shall forward the tax deducted and the accompanying statement to the relevant Tax Authority of the State in which the individual, receiving the payment, is resident.

(d) The person making the remittance of the deduction made shall state the following information in writing:

    (i) Name and address of the person who suffered the tax deduction;

    (ii) Nature of activities or services in respect of which payments were made;

    (iii) Gross amount paid or payable;

    (iv) Amount of tax deducted;

    (v) Amount of tax remitted; and

    (vi) Date of remittance.

(e) For the purpose of final assessment, the individual beneficiary of such income that had suffered deduction of tax at source shall present the original receipt issued in respect of the tax deducted at source, to the relevant Tax Authority for scrutiny whenever a claim for tax credit is made.

(f) Tax deducted from payments made to companies shall be remitted to any of the offices of the Federal Inland Revenue Service.

(g) Deductions at the rates specified above from payments made to a person shall be remitted only to the relevant tax authority of the State in which the person, that is the recipient of the payment, is deemed to be resident.

(h) A body corporate or un-incorporate and any association or institution obliged to deduct tax at source under the Act and by virtue of this Notice, but who fails to do so or having deducted tax, fails to pay over such tax to the relevant tax authority within thirty days from the date the tax was deducted or duty to deduct tax arose, shall be liable on conviction to a

fine of 5,000 in addition to the amount of tax deducted or not deducted together with interest at the prevailing commercial rate. Such payments may also be disallowed as deduction in ascertaining the income or loss for tax purposes of the body corporate or un-incorporate, association or institution.

14.19 OFFENCES AND PENALTIES

The following are offences and the related penalties as specified in PPTA:

Offences	Penalties
(a) Failure to comply with the requirements of a notice served by the Revenue Service.	A fine of ₦10,000. Where the offence arose from failure to deliver accounts or particulars or returns, a further sum of ₦2,000 for each and every day during which the failure continues. In default of payment is imprisonment for six months.
(b) Failure to make up accounts of the company's profits or losses and prepare necessary particulars.	As for (1) above.
(c) Failure to attend, without sufficient cause, in answer to a notice or summons served by the Revenue Service or having attended, failure to answer any question lawfully put.	As for (1) above.
(d) Failure to submit the return of the company's estimated tax within two months of the commencement of the commencement of an accounting period. Failure to submit a revision of the estimate when necessary, is also an offence.	As for (1) above.
(e) Preparation of incorrect accounts of the tax which has been undercharged and particulars or schedules in consequence of such incorrect required by the Act document or information.	A fine of ₦1,000 and double the amount (understating profits or overstating losses).

Offences	Penalties
(f) Giving any incorrect information in relation to any matter or thing affecting a person's liability to tax.	As for (5) above.
(g) Knowingly making any false statement or false representation or using any forged document with a view to obtaining deduction.	A fine of ₦1,000 plus treble the amout of tax involved or to imprisonment for six months, or to both such fine and imprisonment.
(h) Aiding, abetting, assigning, counseling, inciting or inducing any other person to: (a) Prepare and submit false accounts and returns or (b) refuse or neglect to pay tax.	As for (7) abvoe.
(i) Any member of the Revenue Service or any assistant employed in connection with the assessment and collection of tax who - (i) Demands an amount in excess of the authorised assessment of tax payable. (ii) Withholds for his own use or otherwise part of the tax collected. (iii) Renders a false return (verbal or written) of the amount collected by him. (iv) Defrauds, embezzles or otherwise uses his position to deal wrongfully either with the Revenue Service or any other individual. (v) Collects or attempts to collect the tax without being authorised shall be guilty of an offence.	A fine of ₦600 or imprisonment for three years or to both such fine and imprisonment.
(j) Failure to deduct withholding tax or failure to remit the tax deducted to Federal Inland Revenue Service within 30 days.	A fine of 200% of the tax not withheld or not remitted plus interest at the prevailing commercial rate.

The penalty that applies to any other offence under the Act for which the penalty is not specifically stated is as in (1) above, that is, a fine of 10,000 plus 2,000 per day where the offence has to do with failure to deliver a return. An example of an offence for which a penalty is not specifically stated is the failure to pay tax and penalty within one month of the date of issuing a demand note.

The institution of proceedings for or the imposition of a penalty, fine or term of imprisonment in accordance with the provisions of the Act shall not relieve any person from liability to payment of any tax for which he is or may become liable.

14.20 DOUBLE TAXATION ARRANGEMENT (SECTION 61)

(a) If the Minister by order declares that arrangements specified in the order have been made with the Government of any territory outside Nigeria with a view to affording relief from double taxation in relation to tax imposed under the provisions of the Act and any tax of a similar character imposed by the laws of that territory, and that it is expedient that those arrangements should have effect, the arrangements shall have effect notwithstanding anything in any enactment.

(b) The Minister may make rules for carrying out the provisions of any arrangements having effect under this Section.

(c) An order made under the provisions of subsection (1) of this Section may include provisions for relief from tax for accounting periods commencing or terminating before the making of the order and provisions as to income (which expression includes profits) which is not itself liable to double taxation.

(d) Where, before the publication of the Act in the Federal Gazette upon enactment, any order has been made under the provisions of Section 33 of the Income Tax Act and the arrangements specified in that order, with any modifications, are expressed to apply to a tax in a territory outside Nigeria and to income tax in Nigeria and to any other taxes of a substantially similar character either imposed in that territory or Nigeria or imposed by either contracting party to any such arrangements after those arrangements came into force and:

   (i) Such order was made before 1 January, 1958, then, for the purposes of the Act, that order shall be deemed to have been made under this Section on that day, and those arrangements shall have effect, in Nigeria, as respects tax for any accounting period; or

(ii) Such order was made on a day after the year 1957, then, for the purposes of the Act, that order shall be deemed to have been made under this Section on that day and the arrangements specified therein shall have effect, in Nigeria, as respects tax for any accounting period beginning on or after the date when those arrangements come into force, and for the unexpired portion of any accounting period current at that date; and where any arrangements, to which this subsection applies, counting a provision for exchange of information with the Minister as defined in Section 2 of the Income Tax Act then the order, with respect to those arrangements, as deemed to have been made under this Section, shall be deemed to provide for such exchange with the Chairman of the Revenue Service as respects tax.

(e) The Minister may by order replace or vary any order deemed to have been made under this Section for the purposes of the Act, without otherwise affecting such last mentioned order for the purpose of any other Act.

Relief For Double Taxation (Section 62)

(a) The provisions of this Section shall have effect where, under arrangements having effect under Section 61 of the Act, foreign tax payable in respect of any income in the territory with the Government of which the arrangements are made is to be allowed as a credit against tax payable in respect of that income in Nigeria; and in this Section the expression "foreign tax" means any tax payable in that territory which, under the arrangements, is to be so allowed, and "income "means that part of the profits of any accounting period which is liable to both tax and foreign tax, before the deduction of any tax, foreign tax, credit therefore or relief granted under subsection (6) of this Section.

(b) The amount of the credit admissible to any company under the terms of any such arrangements shall be set off against the tax chargeable upon that company in respect of the income, and where that tax has been paid the amount of the credit may be repaid to that company or carried forward against the tax chargeable upon that company for any subsequent accounting period.

(c) The credit for an accounting period shall not exceed whichever is the lower of the following amounts, that is to say:

(i) The amount of the foreign tax payable on the income, or

(ii) The amount of the difference between the tax chargeable under the Act (before allowance of credit under any arrangements having effect under Section 61 of the Act) and the tax which would

be so chargeable if the income were excluded in computing profits.

(d) Without prejudice to the provisions of subsection (3) of this Section, the total credit to be allowed to a company for any accounting period for foreign tax under all agreements having effect under Section 61 of the Act, shall no exceed the total tax which would be ultimately borne by that company, for that accounting period, if no such credit had been allowed.

(e) Where the income includes a dividend and under the arrangements foreign tax not chargeable directly or by deduction in respect of the dividend, is to be taken into account in considering if any, and if so what credit is to be given against tax in respect of the dividend. The amount of the income shall be increased by the amount of the foreign tax not so chargeable, which falls to be taken into account in computing the amount of the credit.

(f) Where the amount of the foreign tax attributable to the income exceeds the credit therefore computed under subsection (3) of this Section, then the amount of that income to be included in computing profits for any purpose of the Act other than that of subsection (3) of this Section, shall be taken to be the amount of that income, increased by the amount of the credit therefore after deduction of the foreign tax.

(g) Where:

(i) The arrangements provide, in relation to dividends of some classes, but not in relation to dividends of other classes, that foreign tax not chargeable directly or by deduction in respect of dividends, is to be taken into account in considering, if any, and if so, what credit is to be given against tax in respect of the dividends; and

(ii) A dividend is paid which is not of a class in relation to which the arrangements so provide, then, if the dividend is paid to a company which controls, directly or indirectly, not less than half of the voting power in the company paying the dividends, credit shall be allowed as if the dividend were a dividend of a class in relation to which the arrangements so provide.

(h) Any claim for an allowance by way of credit shall be made not later than three years after the end of the accounting period, and in the event of any dispute as to the amount allowable the Revenue Service shall give to the claimant notice of refusal to admit the claim which shall be subject to appeal in like manner as an assessment.

(i) Where the amount of any credit given under the arrangements is rendered excessive or insufficient by reason of any adjustment of the amount of any tax payable either in Nigeria or elsewhere, nothing in the Act limiting the time for the making of assessments or claims for repayment of tax shall apply to any assessment or claim to which the adjustment gives rise, being an assessment or claim made not later than three years from the time when all such assessments, adjustments and other determinations have been made, whether in Nigeria or elsewhere, as are material in determining whether any, and if so what, credit falls to be given.

(j) Where a company is not resident in Nigeria throughout an accounting period, no credit shall be admitted in respect of any income included in profits of that company for that period.

14.21 MEMORANDUM OF UNDERSTANDING (MOU)

With effect from 1st January, 1986, the Federal Government of Nigeria entered into an agreement with the oil producing companies (Memorandum of Understanding MOU) granting certain incentives for the following objectives:

(a) Enhancing crude oil exports;
(b) Encouraging investments in exploration and development activities;
(c) Encouraging investments in the area of enhanced oil recovery projects;
(d) Encouraging investments in gas utilisation projects;
(e) Encouraging increased lifting and sale of NNPC's equity crude;
(f) Effectively reducing the tax impact on companies engaging in petroleum operations.

MOU applies to petroleum companies operating joint ventures with NNPC. The purpose of the incentive was to guarantee a $2 per barrel profit margin (after tax and royalty) to the oil company at a notional technical cost of $2 per barrel over the realisable price range of $12.50 - $23 per barrel. Provision was also made in the agreement for certain mechanism to be applied for establishing equitable margin to the oil company for realisable prices less than $12.50/bbl.

Conditions under which the incentives can be granted and penalties for non-compliance:

The oil companies gave the following undertakings:

(a) To lift crude oil which NNPC is unable to lift out of the NNPC equity share of the joint venture production;

(b) To carry out a work programme mutually agreed upon between NNPC and each of the oil companies; and

(c) When an oil company is unable to lift all or part of the notice volume, NNPC levies a penalty of 2% of the average realisable price for each

barrel not lifted. Such penalty is not allowable as a deduction in the calculation of PPT. Where an oil company has not substantially complied with the specified work programme, a notice is served on the company. If within three months of the service of notice, the condition is not remedied, the incentives cease to apply and PPT is computed on pre-1986 basis, until the non-compliance has been remedied.

Government promised that relevant amendments will be promulgated to reflect all the terms of the Memorandum of Understanding. PPTA is yet to be amended. Nevertheless, the agreement has been amended two times but the objectives and the focus remain the same. The first revision was in 1991 and the latest version being that revised in year 2000 which became effective from 1 January, 2000.

Prior to the introduction of the incentives, fiscal regime as at 31 December, 1985 provides for computations of royalty on posted price and petroleum profit tax (PPT) on higher of actual proceeds (Section 9) or posted prices (Section 21, formerly Section 17A). The computations are based on the provisions of the Petroleum Profits Tax Act. The total of the Royalty and PPT calculated is described as Government Take (GT).

Highlights of Year 2000 Memorandum of Understanding (MOU)

(a) Guarantees oil companies a profit margin irrespective of actual market prices of crude oil;

(b) A minimum guaranteed margin of $2.50 per barrel (after tax and royalty) to the oil company on its equity crude;

(c) A minimum guaranteed margin of $1.25 per barrel on NNPC crude which the company lifts and sells;

(d) Notional Technical cost is now set at $4.00 per barrel; and

(e) Where actual Capital Investment Cost (T2) as defined is in excess of $2.00 per barrel on average, then the minimum guaranteed notional margin shall be increased to $2.70 per barrel for the company's equity crude lifted and $1.35 per barrel for NNPC equity crude lifted.

Under the new system, Government Take (Royalty and PPT) relating to the joint venture operations between Nigerian National Petroleum Corporation (NNPC) and each oil company for any fiscal accounting year shall be the lower of Government Take according to the 31/12/85 Royalty and PPT regulations, as amended, calculated by substitution of Posted Price for Official Selling Price (OSP) and Revised Government Take (RGT) calculated by substitution of Posted Price with Tax Reference Price (TRP).

First, Government Take will be calculated on the basis of the provisions of the Petroleum Profits Tax Act. Government Take is the Royalty payable by the oil company for the fiscal year plus the Petroleum Profits Tax as computed under

the provisions of PPTA that is substituting Posted Price for Official Selling Prices if higher.

Next, RGT (Royalty and PPT) will be calculated applying the various formulae contained in the Memorandum of Understanding substituting Posted Price with Tax Reference Price.

The lower of Government Take and RGT will be the total amount payable to government for that fiscal year.

Government Take will be calculated in Naira each month and compared for the same volume of exports with Government Take for the same month under the terms of the 31/12/85 Royalty and PPT regulations. Identical rates of exchange will be used to convert US Dollar prices to Naira in both Government and Revised Government Take calculations. The amount by which Revised Government Take is less than Government Take 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 the fiscal accounting period.

The following are some of the definitions and formulae in the 2000 MOU that are to be applied in the calculation of RGT.

Production Operating Expenses (T1)

Production operating expenses are:

(a) Direct production expenses

(b) Portion of administrative and general expenses allocated to production

(c) Custom duties and gross rental allocated to production

(d) Extraordinary/prior year expenses/incomes

Capital Investment Costs (T2)

Capital Investment costs include:

(a) Exploration costs

(b) Appraisal drilling costs (first and second wells)

(c) Intangible drilling and development cost

(d) Capital allowances

Guaranteed Notional Margins

The guaranteed notional margins are dependent on the crude oil realisable prices in the following ranges:

Below $13.48/bbl,

Between $13.48 and $15/bbl,

Between $15 and $19/bbl,

Greater than \$19/bbl and less than or equal to \$30/bbl

Realisable prices below \$13.48 bbl,

Guaranteed notional margins for realisable prices less than \$13.48/bbl shall be established as follows:

M = (1 – FC/RP) x (RP1a1 + RP2a2 + RP3a3)

Where:

M = Applicable Guaranteed Notional Margin for RP less than \$13.48/bbl

RP = Realisable Price

FC = Notional Fiscal Technical Cost of \$4.00/bbl

a = Company's Percentage share of field profit

For:

Realisable Price in the Range		Company Share Applicable to Price Range	
		T2 <= 2.00	T2 > 2.00
\$0 < RP1 < \$5/bbl	a 1=	0.300	0.365
\$5 < RP2 < \$10/bbl	a2=	0.285	0.28833
\$10 < RP3 < \$13.48/bbl	a3=	0.10744	0.08286

Realisable prices greater than \$19/bbl and less than \$30/bbl:

For realisable prices greater than \$19/bbl but less than \$30/bbl, guaranteed notional margin is calculated as follows:

M = M19 + (RP – 19) x a

Where:

M = Applicable Guaranteed Notional Margin for \$19 < RP <= \$30

M19 = \$2.50/bbl when actual capital investment cost (T2) is \$2/bbl or less
= \$2.70/bbl when actual capital investment cost (T2) is greater than \$2/bbl

RP = Realisable price

a = Company's share of field profit

For:

Realisable Price in the Range		Company Share Applicable to Price Range	
		T2 <= 2.00	T2 > 2.00
\$19 < RP < \$ 30/bbl	a =	0.1160	0.1315

Realisable Prices in excess of $30

For Realisable Prices in excess of $30 per barrel, the Minister of Petroleum shall advise any change in applicable margins. Such advice shall only be necessary when RP exceeds $30 per barrel for at least 45 days continuously.

Tax Reference Price (TRP)

Tax Reference Price shall be calculated as per the following formula:

$$TRP = \frac{RP - (M + 0.15 \times FC)}{0.88}$$

Where:

RP = Realisable Price

M = $2.50/bbl when actual capital investment cost (T2) is $2/bbl or less

= $2.70/bbl when actual capital investment cost (T2) is greater than $2.00/bbl

FC = Notional Fiscal Technical Cost of $4.00/bbl

Revised Royalty (ROY_{TRP})

Under the 2000 MOU, Revised Royalty (ROY_{TRP}) shall be determined by substituting Posted Price in the PPTA with the determined TRP as follows:

ROYTRP = RR x TRP x V

Where:

RR = The applicable royalty rate according to the 31/12/1985 Royalty and PPT regulations, as amended

TRP = Tax Reference Price as determined in clause 2.4.1 of the MOU

V = Company's crude oil and condensate production

Revised PPT ($PPT\text{-}_{TRP}$)

Revised PPT is calculated as follows:

$PPT\text{-}_{TRP} = [(TRP \times Vs) - ROY_{TRP} - TC] \times TR$

Where:

TRP = Tax Reference Price as determined in clause 2.4.1 of the MOU

Vs = Company's crude oil and condensate sales volume

$ROY\text{-}_{TRP}$ = Revised Royalty as determined in clause 2.4.2 of the MOU

TC = Deductions under Sections 10, 14 and 18 (excluding Royalty) of the PPTA and its amendments

TR = Applicable Tax Rate

Tax Inversion Penalty

One of the objectives of the MOU is to encourage investment in the petroleum industry and maintain cost efficiency. One way of encouraging cost efficiency is the introduction of the Tax Inversion rate of 35% in the 2000 MOU.

To the extent that T1 as defined in Appendix 1 (paragraph 1) of the MOU is less than $1.70/bbl for any calendar year, then the Tax Inversion Penalty (TIP), as used in the Revised Government Take formula shall be calculated as follows:

TIP = (TR – TIR) x (T1 – LTIT) x V

Where:

LTIT = Lower Tax Inversion Threshold = 1.70/bbl
TR = Applicable Tax Rate
TIR = Tax inversion rate = 35%
T1 = as defined in Appendix 1 (paragraph 1) of the MOU
V = company's crude oil and condensate production

To the extent that T1 is greater than $2.30/bbl for a calendar year for companies producing above an average of 175,000 bbls/day in the same calendar year, or $3.00/bbl for a calendar year for companies producing below an average of 175,000 bbls/day in the same calendar year, then the Tax Inversion Penalty (TIP) shall be calculated as follows:

TIP = (TR – TIP) x (T1 – UTIT) x V

Where:

UTIT = Upper Trigger Point for Tax Inversion for T1= $2.30/bbl for companies
producing above an average of 175,000 bbls/day in the same calendar year or $3.00/bbl for companies producing below an average of 175,000 bbls/day in the same calendar year.

TR = Applicable Tax Rate
TIR = Tax inversion rate = 35%
T1 = as defined in Appendix 1 (paragraph 1) of the MOU
V = Company's crude oil and condensate production.
To the extent that V, as defined below, is adversely impacted by circumstances outside the control of the company, UTIT shall be adjusted to negate such adverse impact the procedure of which is set out in Appendix C to the MOU.

Revised Government Take (RGT)

Revised Government Take is simply the sum of the revised royalty, revised PPT and the Tax inversion penalty. Revised Government Take (RGT) is defined as:

RGT = $ROY_{TRP} + PPT_{TRP} + TIP$

Where:

ROYTRP = Revised Royalty as determined in clause 2.4.2 of the MOU
PPTTRP = Revised PPT as determined by clause 2.4.3 of the MOU
TIP = Tax Inversion Penalty as determined by clause 2.7

Ullage fees

For the purpose of the cost control mechanism, the Ullage fees paid to a third party in respect of crude oil transportation, processing and terminalling is made up of 50% operation and 50% capital costs. The capital cost part of such haulage fees shall be excluded from T1 as defined in Appendix 1 (paragraph 1) of the MOU.

14.22 COMPANIES ENGAGED IN UTILIZATION OF ASSOCIATED GAS

Gas Industry Incentives

The following were the major disincentives to gas production in Nigeria prior to 1 January 1997:

(a) High Corporate tax rate particularly the Petroleum Profits Tax rate as the taxation of gas is under the Petroleum Profits Tax Act.

(b) Limited market.

(c) Limited numbers of appropriate reservoirs conducive for gas reinjection/ storage and the economies of doing so.

(d) The huge cost of developing major and inter-connecting network of gas pipelines,

(e) Low technological and industrial base for energy consumption in the country and limited regional and international gas market.

(f) Inadequate fiscal and gas pricing policies to encourage investment.

(g) The difficult terrain of the Niger Delta which hinder the gas gathering process.

With effect from 1 January 1997, a Section 10A has been inserted in the Petroleum Profits Tax Act, with the following provisions:

(a) The following incentives shall apply to a company engaged in the utilization of associated gas, that is:

    (i) Investment required to separate crude oil and gas from the reservoir into usable products shall be considered as part of the oil field development;

    (ii) Capital expenditure 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 field development;

    (iii) Capital allowances, operating expenses and basis of tax assessment shall be subject to the provisions of the Act and the tax incentives under the revised MOU.

    (iv) Gas to be transferred at 0%royalty and 0% Petroleum Profit Tax.

    (v) Plant and machinery for gas utilization are exempted from import duties.

(b) The incentives specified under subsection (1) of this Section shall be subject to the following conditions, that is:

(i) 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;

(ii) The company shall pay the minimum amount charged by the Minister of Petroleum Resources for any gas flared by the company;

(iii) 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;

(iv) 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;

(v) Only companies which invest in natural gas liquid extraction facilities to supply gas in usable form to downstream projects, including aluminium smelter and methanol, Methyl Tertiary Butyl Ether and other associated gas utilization projects shall benefit from the incentives;

(vi) All capital investments relating to the gas to liquids facilities shall be treated as chargeable capital allowance and recovered against the crude oil income;

(vii) Gas transferred from the natural gas liquid facility to the gas-to-liquids facilities shall be at zero per cent tax and zero per cent royalty.

There is apparently no distinction between associated gas and non-associated gas in The Petroleum Profits Tax Act. All incentives in respect of investments in associated gas also apply to investments in non-associated gas.

14.23 JOINT VENTURE AND PRODUCTION SHARING CONTRACTS

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 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.

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:
(a) Royalty Oil
(b) Cost Oil
(c) Tax Oil
(d) 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 Act No 9 of 1999. The Decree requires that the tax computation is done by NNPC or concession holder who will also lift the "Tax Oil", sell same, and pay 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 PPTA. 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 Act 1999 are:

(a) 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.

(b) 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-

 (i) 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;

 (ii) 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.

(c) In both cases, royalty is payable as follows:

		Rate
(i)	In areas from 201 to 500 metres water depth	12%
(ii)	From 501 to 800 metres water depth	8%
(iii)	From 801 to 1000 metres water depth	4%
(iv)	In areas in excess of 1000 metres water depth	10%
(v)	The royalty payable in respect of Inland Basin shall be	10%

(d) Computation and payment of estimated and final petroleum profits tax shall be made in US dollars on the basis of the US dollar returns filed.

(e) 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.

(f) 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.

(g) The chargeable tax on petroleum operations in 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.

14.24 CHAPTER REVIEW

This chapter identifies companies engaged in petroleum operations which are chargeable to tax under the Petroleum Profits Tax Act CAP P13 LFN 2004. It also deals with the provisions of the Deep Offshore and Inland Basin Production Sharing Contract Act 9 of 1999; the current Memorandum of Understanding (Year 2000 MOU) agreement between the Federal Government and the petroleum companies and applicable side letters:

Companies that are engaged in petroleum exploration, development, production and sale of crude oil and gas are in the upstream operations and are chargeable to tax under PPTA. Those that are engaged in processing the crude oil and gas and marketing of refined crude oil, etc. are in downstream operations. These are chargeable to tax under the provisions of the Companies Income Tax Act.

The provisions of PPTA and MOU apply to petroleum companies operating under joint venture while in respect of companies operating under Production Sharing Contracts, the provisions of PPTA and Deep Offshore and Inland Basin Production Sharing Contracts Act apply.

Petroleum profits tax computation will normally take the following pattern:

(a) Ascertain the profits of the accounting period.
This will be the fiscal value of chargeable oil and gas sold plus all income received by the company that are incidental to petroleum operations.

If there is no indication to the contrary any income described as miscellaneous income, interest on bank fixed deposit accounts, etc. should normally be regarded as incidental to petroleum operations. In the computation of the fiscal value of chargeable oil sold, with respect to crude oil exported, the higher of the selling price or the posted price will be used; while in case of crude oil sold locally , it is the actual amount realised from the sale, that will be used.

For companies operating under Production Sharing Contracts, note that Petroleum Profits Tax Computations will be based on the provisions of the particular contract with each of the company.

(b) Deduct all Section 10 allowable expenditures having regard to the allowable and disallowable expenditures rules.

The figure arrived at is the adjusted profit.
From the adjusted profit deduct any unrelieved petroleum operations' loss brought forward from previous period to arrive at the assessable profit.
(Remember that there is no time limitation for the relief of losses as the case is in companies chargeable to tax under CITA).

(c) Capital allowances will be deducted (remember to apply the restriction) from the assessable profit to give the chargeable profit.

(d) Apply the PPT rate (presently 85% or 50% in respect of PSC, or 65.75% for local sales or 40% for sale of natural gas) to the chargeable profit to get the assessable tax.

(e) The tax offsets to be deducted in accordance with the provisions of Section 20 from the assessable tax will then be deducted to arrive at the chargeable tax. This will now only apply to companies operating under PSC.

For companies operating under Joint Venture, compute the amount of MOU credit due. This will be deducted from the chargeable tax to arrive at the tax payable.

It is usually the chargeable tax that would be paid to the Revenue Service after deducting the total of the amounts paid to date through the monthly instalments determined on the basis of the estimated tax for the accounting period.

Withholding tax, if any, suffered by the company is also to be deducted from the chargeable tax to arrive at the tax that will be payable. Remember, withholding tax is an advance payment on account of the tax that will be due for payment by each company.

The presentation of a PPT computation would appear thus:

XYZ PETROLEUM LIMITED
2008 PETROLEUM PROFITS TAX COMPUTATION

	N'million
Fiscal value of chargeable oil	xxx
Add: Other income incidental to petroleum operations	xxx
Profit of the accounting period	xxx
Less: Allowable deductions	(xxx)
Adjusted profit of the accounting period	xxx
Deduct: Unrelieved loss brought forward	(xxx)
Assessable profit	xxx
Less: capital allowances (Restricted to lower of actual allowances and 85% of assessable profit less 170% of petroleum investment allowance)	(xxx)
Chargeable profit	xxx
Assessable tax at 85% of chargeable profit; or 65.75% in respect of crude sold locally; or 40% for natural gas sold; or 50% for PSC operators.	xxx
Less: Section 20 deductions:	
Investment tax credit (applicable to PSC operators)	(xx)
Chargeable tax	xx
Deduct: MOU Credits (Joint Venture Operators only)	(xx)
PPT Payable	xx

14.25 WORKED EXAMPLES

14.25.1 Questions

1. Explain the following terms:
   (a) Tax Inversion Penalty
   (b) Revised Government take
   (c) Ullage Fees

2.(a) Define the following in relation to Petroleum Profits Tax Act.
   (i) The Board
   (ii) Chargeable natural gas
   (iii) Casing head petroleum spirit
   (iv) G-Factor

(b) SSV Nigeria Ltd engaged a firm of Tax Consultants – KMK and Associates – to compute its Petroleum Profits Tax payable for the year ended 31 December 2008. The Petroleum Profits Tax was computed at ₦680,000,000 after the following deductions had been made:

Royalties on domestic sales	100,000,000
Customs duties on plant and machinery	160,000,000
Capital allowances b/f	40,000,000
Capital allowances for current year	90,000,000
Agreed loss b/f	100,000,000

The following additional information is also relevant:

(i) Memorandum of understanding (M.O.U.) credit 46,000,000

(ii) Royalties on export sales 200,000,000

(iii) Other incomes amounted to ₦26,000,000 including 4,000,000 for transportation of crude oil and 2,000,000 for disposal of fixed assets.

(iv) Tangible drilling expenses ₦120,000,000 capitalised and Intangible expenses amounted to 100,000,000.

(v) Non-productive rent – 10,000,000.

(vi) Additional assets for off-shore operations ₦30,000,000.

Required:

Compute the Petroleum Profits for the accounting period ended 31 December 2008.

(c) Describe briefly, what you understand by the term "Memorandum of Understanding" as it applies in Petroleum Profits Tax Computation.

3. Forcados Limited is operating a Joint Venture with NNPC under the Year 2000 Memorandum, while Bonny Limited is an operator under the sole risk operation. The following information relate to the companies operation for the accounting year ending 31 December 2001

Total Production	105,000 barrels
Total Export	105,000 barrels
Realisable Price	$28.5846
Applicable Tax Reference Price	$27.3867
	$"000
Direct lifting cost	171
Health safety and environment	12
Direct handling cost	18
Field production overheads	24

Personnel and utilities	66
Materials handling	75
Capital allowances	461.04
Investment allowances	45.20
Royalty rate	22%

You are required to compare the effects of incentives on Joint Venture System as against the Sole Risk Operation

Government Take = Royalty Plus Assessable Tax

Tax Inversion Penalty = $\frac{0.85-0.35}{(TR-TIR)\ x\ TI\ per\ barrel\ lost-TIT)\ x\ V}$

TR = Applicable Tax Rate
TIR = Tax Inversion Rate
TI = Per Barrel
TIT = $3.00/bbl for companies producing below an average of 175,000 bbls/day in the same calendar year
Ti per barrel = Allowable Deductions/Production
531,000/105,000 = 5.06
TIP = (0.85 – 0.35) x (5.05 – 3.00) x 105,000
= 0.50 x 2.05 x 105,000 = 107,625

4. SSV Petroleum Company Ltd. has the following particulars to present for the year ended 31 December 2003.

	₦'000	₦'000
Sale of Crude Oil – Export		556,600
Sale of Natural Gas		30,250
Other Incidental Income		3,025
The expenses incurred during the period are as follows:		
Production		145,200
Administration		193,600
Intangible Drilling Cost	30,250	
Non-productive rentals	12,100	
Royalties on export		3,025
Royalties on local Sales		1,210
Custom duties on plant and machinery	18,150	
Provision for restoration of wells	90,750	

The following additional information is provided

(i) Memorandum of understanding (MOU) Credit ₦12,100,000
(ii) Petroleum Investment Allowance has been agreed at ₦9,075,000
(iii) Depreciation included in production expenses amounted to ₦24,200,000
(iv) Capital allowances agreed with the Federal Inland Revenue is ₦36,300,000.

Required:

(a) Compute the chargeable tax for the relevant accounting period.

(b) Describe briefly, what you understand by the term "Memorandum of Understanding" as it applies in petroleum profits tax computations.

14.25.2 Suggested Solutions

1 (a) A major objective of the MOU is to encourage investment in the Petroleum Industry and maintain cost efficiency. The manner of encouraging cost efficiency is the introduction of the Tax Inversion Rate of 35%.

To the extent that TI (As defined in Appendix I (Paragraph I of the MOU is less than $1.70/bbl for any calendar year, then the TIP as used in the Revised Government Take formula shall be:
TIP = (TR – TIR) x (TI – LTIT) x V
TR = Applicable Tax Rate
TIR = Tax Inversion Rate = 35%
TI = as defined in Appendix I (paragraph I) of the MOU i.e Allowable Deduction/Barrel
LTIT – Lower Tax Inversion Threshold = 1.70/bbl
V = Company's crude oil and condensate production

Where a company produces below an average of 175,000 bbls/day, in the same calendar year, the TI is $.3.0/bbl and $2.30/bbl for companies producing above an average of 175,000 bbls/day

TIP = (TR – TIR) x (TI – UTIT) x V

(b) **Revised Government Take**

This is simply the sum of the revised royalty, revised Petroleum Profit Tax and the Tax Inversion Royalty

$RGT = Roy_{TRP} + PPT_{TRP} + TIP$

Roy_{TRP} = Revised Royalty as determined in Clause 2.42 of the MOU

PPT_{TRP} = Revised PPT as determined by Clause 2.4.3 of the MOU

TIP = Tax Inversion Penalty

(c) **Ullage Fees**

Ullage fees paid to a third party in respect of crude oil transportation, processing and terminalling is made up To 50% operation and 50% capital cost. This is for the purpose of cost control mechanism.
The capital cost part of the Ullage fees shall be excluded from TI (Allowable Deduction/bbl) as explained in the MOU.

2. (a) (i) **Board**
Means the Federal Inland Revenue Service Board

(ii) **Chargeable Natural Gas**
In relation to a company engaged in petroleum operations means Natural Gas actually delivered by such company to the Nigerian National Petroleum Corporation under a Gas Sales Contract but does not include Natural Gas taken by or on behalf of the Government of the Federation of Nigeria.

(iii) **Casing Head Petroleum Spirit**
Means any liquid hydrocarbons extracted in Nigeria from Natural Gas by a process of separation or by any other chemical or physical process but before the same has been refined or treated in any other way.

(iv) **G-Factor**
Means gas production cost adjustment factor

(b) **SSV NIGERIA LIMITED**
2008 PETROLEUM PROFITS COMPUTATION

	₦
Chargeable tax as given	680,000,000
This represents 85% of Chargeable Profit	
Previous chargeable profit	
= 680,000,000 / 800,000,000 85%	
Add Items already deducted:	
Royalties on Domestic Sales	100,000,000
Custom Duties on Plant and Machinery	160,000,000
Capital Allowance b/f	40,000,000
Capital Allowance for Current Year	90,000,000
Agreed Loss b/f	100,000,000
	490,000,000
	1,290,000,000
Add Other Income	20,000,000
Petroleum Profits for the Accounting Period	**1,310,000,000**

In view of insufficient information in the question as to the volume of export and local crude sales respectively, it has been assumed that the tax rate of 85% for export crude sales was used in the tax computation. The rate of 65.75% applicable to local crude sales has therefore been ignored.

(c) Memorandum of Understanding (MOU) in relation to Petroleum Profits Tax
Computation is a form of tax credit allowed to petroleum producing companies, which effectively reduces their Petroleum Profits Tax liability. MOU is to encourage oil-producing companies to invest more in the petroleum industry. It is calculated by the use of an offset price as well as a series of formulae.

3.

	Forcados Limited $'000	Bonny Limited $'000
Export Value	2,875,604	3,001,383
Royalty	(632,633)	(660,304)
Section 10 deductions (Except Tertiary Education Tax)	(531,000)	(531,000)
Adjusted Assessible Profit before T.E.T	1,711,971	1,810,079
Tertiary Education Tax @2/102 of Ass.Profit	(33,568)	(35,492)
Assessable Profit After Education Tax	1,678,403	1,774,587
Dd Capital Allowance plus Inv. Allowance	(506,240)	(506,240)
Chargeable Profit	1,172,163	1,268,347
Assessable Tax e85%	996,339	1,078,095
Government Take/Revised Government Take Excluding T.I.P	1,628,972	1,738,399
Revised Government Take (Including Tax Inversion Penalty)	1,736,597	

From the information, the following are the differences as a result of the incentives to Forcados

(a) The Export Value of Forcados is higher than that of Bonny Limited because of the higher pricing value
(b) Royalty payable is higher for Bonny Limited
(c) Assessible Profit of Forcados is lower than that of Bonny Limited
(d) Forcados has a lower chargeable profit
(e) The Assessible Tax of Forcados is lower than that of Bonny Limited
(f) Forcados pays lower Government Take (PPTT Royalty) than Bonny Limited
(g) As a result of the cost inefficiency in A, it is liable to a Tax Inversion Royalty of ₦1, 736, 597

The above are the direct impact of incentives available to Forcados from the 2000 memorandum.

4.(a) **SSV PETROLEUM COMPANY LIMITED**
PETROLEUM PROFITS TAX COMPUTATION – 2003

	₦'000	₦'000
Profit of the accounting period:		
Export sale of Crude Oil	556,600	
Sale of Natural Gas	30,250	
Other incidental income	3,025	
	589,875	
Less Section 10 allowable expenditure:		
Production	145,200	
Less depreciation	24,200	121,000
Administration		193,600
Intangible Drilling Cost		30,250
Non-productive Rentals		12,100
Royalties on Export		3,025
Royalties on local sales	1,210	
Custom duties on plant	18,150	(379,335)
		210,540
Education tax 2/102 x 210,540		(4,128)
Assessable profit		206,412
Less Capital allowances:		
As agreed with FIRS		36,300
Petroleum Investment Allowance		9,075
		45,375
Maximum = 85% of 206,412	175,450	
Less 170% of 9,075	(15,428)	
	160,022	
Capital allowances claim		(45,375)
Chargeable profit		161,037
Assessable tax at 85% thereon		136,881
Less Section 20 Tax offsets:		-
Chargeable tax		136,881
Less MOU Credit		12,100
PPT Payable		124,781
Education Tax 2% of 206,412		4,128
In practice, the applicable rates are:		
Export Crude Sales		85%
Gas Sales		40%.

The 85% rate applied above is for simplification and is considered acceptable under examination condition although the student will append a note similar to this to let the examiner know that the student is aware of the tax rate for gas sales.

(b) Memorandum of Understanding (MOU) as it applies to petroleum profits tax computation refers to a tax credit allowed to petroleum producing companies which reduces their Petroleum profits tax liability. MOU is to encourage the oil producing companies to invest more in petroleum operations industry. The credit is arrived at by using some formulae in the MOU to calculate a Revised Government Take (RGT). This is compared with what is Government Take (GT). Petroleum profits tax computation based strictly on the PPTA Cap 354 1990 LFN, will be higher than PPT calculated making use of the MOU formulae. The difference is described as MOU Credit.

The purpose of the incentive (under the 2000 MOU) is to guarantee a $2.50 per barrel profit margin (after tax and royalty) to the oil company at a notional technical cost of $4.00 per barrel over the realisable price range of up to $30 per barrel.

CHAPTER 15

Interpretation of Tax Laws

Contents

1. Purpose
2. Introduction
3. Cardinal Rules for Interpretation of Taxing Statutes
4. Chapter Review
5. Worked Examples

15

INTERPRETATION OF TAX LAWS

15.0 PURPOSE

After studying this chapter, readers should be able to:

(a) interpret tax laws, using decided cases; and

(b) know the principles on which decided cases are based.

15.1 INTRODUCTION

In the interpretation of taxing statutes, there are principles on which the interpretation of a particular statute is done by the courts and legal practitioners and tax experts are expected to have the knowledge in order to understand the statutes and their implications.

These fundamental principles guide the judges in interpreting the laws and also in arriving at their decisions. L.J Denning in Seafood Court Estates v Asher (1949) 2 All ER 155 had this to say:

"A judge must not alter the material of which the Act is woven but he can and should iron out the creases. When a defect appears, a judge cannot simply fold his hands and blame the draftsman. He must set to work on the constructive task of finding the intention of the Parliament and then he must supplement the written words so as to give force and life to the intention of the legislature. Also in FCT v Westraders Barwick CJ said: "It is for the parliament to specify and to do so, in my own opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax." The function of the court is to interprete and apply the language in which Parliament has specified in those circumstances. The court is to do so by determining the meaning of the words employed by the Parliament according to the intention of the Parliament, which is discoverable from the language used by the Parliament. It is not for the court to mould or attempt to mould the language.

Barwick to a strict literal approach to interpreting taxation legislation. Barwick approach were that taxes were penalties imposed by the state, which stood between citizens and their right to prosper from their enterprise. The tax laws could be construed in highly technical terms, without regard for the purpose they were designed to serve.

Justice Graham hills of the Australian High Court, his views as to the correct approach for a court to take in interpreting taxation legislation, made it clear that a court should adopt a purposive approach by applying the ordinary

meanings of the words used to give effect to the legislative purpose behind the legislation. This approach requires looking to the context of the legislation in its widest sense to give effect to the objects of the legislation. However, such approach not be used to advance any personal theories of justice.

15.2 CARDINAL RULES FOR INTERPRETATION OF TAXING STATUTES

15.2.1 Rule of literal interpretation

This principle is based on the fact that if the language of the statute is clear and unambiguous, Courts must give words their ordinary meaning. Courts have no authority to place a different construction on it, even if it leads to an injustice, it must apply it according to its terms as pronounced in CIT VS T. V Sndaram Iyyengar (1975).

(a) **CIT vs Elphinstone Spg & Wvg Mills Co. Ltd.** 40 ITR 142 (SC) and CIT vs Motors & General Stores Ltd. 66 ITR 692, 699-700 (SC)

No tax can be imposed on the subject without words in the Act clearly showing an intention to lay a burden upon him. In other words, the subject cannot be taxed unless he comes within the letter of the law. The argument that he falls within the spirit of the law cannot be available by the Department.

(b) **City of Jesup vs. Bennett. 226. Ga.606 (1970)**

Where the language of an act is plain and unequivocal, judicial construction is not only unnecessary but is forbidden.

(c) Rowlatt J. in **Cape Brandy Syndicate vs IRC** (1921) 1 KB 64 approved in **CIT vs Ajax Products Ltd.** (1965) 55 ITR 741 (SC).

"In a taxing Act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look at the language used." (p. 747).

Thus, when the language of a taxing statute is clear, if an assessee falls within the four corners of the statute, he is to be taxed; if not, no tax is to be levied.

(d) **Smt. Tarulata Shyam vs. CIT** (1971) 108 ITR 345 (SC). There is no scope for importing into the statute words which are not there. Such importation would be, not to construe, but to amend the statute. Even if there be a casus omissus, the defect can be remedied only by Legislation and not by judicial interpretation.

15.2.3 Golden Rule (Doctrine of purposive construction)

If the strict interpretation of the taxing statute is likely to lead to a manifest absurdity, then the golden rule of construction implies that the meaning of the words should be so effected that such an absurdity is avoided. The application of this rule is rather limited in the realm of construction of taxing statutes, since the literal rule would gain precedence over the golden rule and it is often remarked that equity and taxation are strangers – **Grey vs. Pearson** (1857) 6 HL 61, 106.

15.2.4 Rule of harmonious construction

When any provision of a taxing statute is interpreted, it must be so constructed that the meaning of such provision must harmonise with the intention of the Legislature behind the provision in particular and the enactment in general – **CIT vs. Chandanben Maganlal** (2002) 120 Taxman 38 (Guj.). However, this would always be subject to the fact that the particular provision, or even the entire enactment, should not be held unconstitutional.

15.2.5 Doctrine of 'reading down'

Resort to reading down is done where a legal provision; read literally, seems to offend the Constitutional provisions concerning fundamental rights or is found to be outside the competence of the particular Legislature. Some relevant decisions are given hereunder.

(a) **Sri Venkateshwara Timber Depot vs. Union of India** (1991) 189 ITR 741/155 Taxman 308 (Ori). The Court construes the provision in question in a limited sense to ensure that its meaning falls within the parameters of constitutionality or is intra vires the powers of the Legislature in question (generally in the case of State Legislatures).

(b) **Arun Kumar vs. UOI** (2006) 155 Taxman 659 (SC) Reading down a provision is based on the premise that to sustain the law by interpretation is the rule. To add further, as held in **Kedar Nath Singh vs. State of Bihar** AIR 1962 SC 955.

"The Legislature is presumed to be aware of its limitations and is also attributed an intention not to overstep its limits."

15.2.6 Rule of Beneficial Construction

In cases where there are two interpretations possible, the one which is beneficial to the assessee would be preferred. This principle was laid down in a landmark judgment in **IRC vs. Duke of Westminister** 1936 AC 1 wherein Tomlin LJ stated that an assessee may arrange his affairs within the bounds if the law so as to minimize the incidence of tax.

(a) **McDowell & Co. Ltd. Vs. CTO** (1985) 154 ITR 148 (SC). The Apex Court clamped down on the liberal construction and the pendulum swung to the other extreme, as the Court made fine distinctions between tax evasion, tax avoidance and tax planning and virtually rendered the **Westminister** Principle nugatory. Here, the Court followed the interpretation that the letter and spirit of the law must be followed. In this post-McDowell era, the department generally got favourable verdicts and a lot of assesses suffered due to the Courts coming down heavily on tax avoidance measures, which were equated with tax evasion.

(b) **UOI vs. Azadi Bachao Andolan** (2003) 263 ITR 707 (SC)
The case dealt with conflicts between the Indo-Mauritious Double Tax Avoidance Agreement and the Income Tax Act, 1961, it was held that an assessee was entitled to arrange his affairs so as to minimize the incidence tax, thus, partly confirming the **Westminister** Principle.

15.2.7 Charging sections to be strictly construed while benevolent and procedural sections should be liberally construed.

This is a very important and practical rule of interpretation and generally resorted to while interpreting the sections pertaining to incentives, exemptions and deductions where the spirit is to promote exports, increase earnings in foreign convertible exchange, promote industrialization, infrastructure development etc. A provision for appeal should also be liberally construed.

(a) **CIT vs. Naga Hills Tea Co. Ltd.** 89 ITR 236, 240 (SC); **CIT vs. Contr ED vs. Ka nakasabai** 89 ITR 251, 257 (SC)
A provision for exemption or relief should be construed liberally and in favour of the assessee even if it results in his obtaining "a double advantage".

(b) **Gursahai Saigal vs. CIT** 48 ITR (SC) 1
Those sections which impose the charge or levy should be strictly construed; but those which deal merely with the machinery of assessment and collection should not be subjected to a rigorous construction but should be construed in a way that makes the machinery workable.

(c) **Bajaj Tempo Ltd.** 196 ITR 188 (SC)
A provision in a taxing statute granting incentives for promoting growth and development should be construed liberally, and since as provision for promoting economic growth has to be interpreted liberally, the restriction on it too has to be construed so as to advance the objective of the provision and not to frustrate it. While

interpreting the various provisions, the Court must not adopt a hyper technical approach and apply cut and dry formula. A pragmatic approach should be adopted so that the object of the introduction/insertion of a particular provision could be achieved.

(Similar views have been expressed in **Juggilal Kamlapat vs. CIT** (1969) 73 ITR 702 (SC), **CIT vs. Strawboard Manufacturing Co. Ltd.** (1989) 177 ITR 431 (SC) at page 434 and **CIT vs. South Arcot District Co-operative Marketing Society Ltd.** 176 ITR 117 (SC) at page 119]

(d) **CIT vs. Poddar Cement (P.) Ltd.** [1997] 226 ITR 625 (SC)
Where there are two possible interpretations of a particular section which is akin to a charging section, the interpretation which is favourable to the assessee should be preferred while construing that particular provision. Reiterating the same view, in the case of **CIT vs. Shaan Finance (P.) Ltd.** [1998] 231 ITR 308 (SC) it has been held that in interpreting a fiscal statute, the Court cannot proceed to make good the deficiencies if there be any. The Court must interpret the statute as it stands and in case of doubt, in a manner favourable to the taxpayer.

(e) **CIT vs. Vegetable Products Ltd** [1973] 88 ITR 192
It has been held that if the Court finds that the language of taxing provision is ambiguous or capable of more meaning than one, then the Court has to adopt the interpretation which favours the assessee.

(f) **Gannon Dunkerly & Co. Ltd. vs. CBDT** 159 ITR 162 (Bom.)
The object of section 80-O is to encourage the export of Indian Technical Knowhow and augmentation of foreign exchange resources of the country and hence a superficial and narrow interpretation can only defeat the benevolent purpose behind the provision of section 80-O.

15.2.8 Mischief rule (Heydon's case 1584) .3 Co. Rep.7a, 7b

This rule is one of the canons of statutory interpretation and its basis lies in the four aspects outlined below :

(a) What was the common law prior to the enactment of the statute?
(b) What was the defect or mischief which the common law failed to rectify?
(c) What remedy did the Legislature provide by way of the statute enacted?
(d) What was the legislative intent behind such remedy?

The application of the mischief rule would generally be done very rarely in taxing statutes, since a Court would have to exhaust all the other modes and aids to interpretation before applying the 'mischief rule'.

15.2.9 Construction of penal provisions

There are several penal provisions in taxation statutes and these have special rules of interpretation and notable among these are:

(a) Strict construction

(b) Prospective in operation and not retrospective; thus, any act which is currently not an offence cannot be made one retrospectively by amendment of a penal provision with retrospective effect;

(c) presumption of mens rea (i.e., guilty intention to commit the crime) unless the statute specifically provides for the absence of the same.

To illustrate, concealment of income may be presumed by the department (without mens rea) and the onus of proof lies on the assessee to show that there is no concealment.

i. **Jarnail Singh vs. ITO** [1989] 179 ITR 426 (P&H); **CIT vs. Gangaram Chapolia** [1976] 103 ITR 613 (Ori.)(FB)

To bring an act under the provisions of section 276C, the action of the person concerned has to be a wilful attempt to evade any tax, penalty or interest chargeable or imposable under the Act. The word 'wilful' imparts the concept of mens rea, and if mens rea is absent, no offence under this section is made out.

15.2.10 Rule of 'Ejusdem Generis' or Noscitur a Sociis

The Rule is that the meaning of a general word is restricted by the special words appearing along with it. To illustrate:

Gore vs. State .79 Ga. App: 669 (1949)

When a statute includes general terms, following specific terms, the general terms are confined to the same kind as the specific term.

"If a man tells his wife to go to the market to buy vegetables, fruits, groceries and anything else she needs, the 'anything else' would be taken to mean food and grocery items due to the rule of ejusdem generis and not cosmetics or other feminine accessories."

Thus, the meaning of a word must be taken by the company it keeps (Rule of noscitur a sociis). In the case of **CIT vs. Raj Kumar** [2009] 181 Taxman 155 (Del.) regarding Deemed dividend under section 2(22)(e) of the Income-tax Act, 1961, the word 'advance', which appears in company of word 'loan' was interpreted. Section 2(22)(e) reads as "any payment by a company, not being a company in which the public are

substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) [made after the 31 May 1987, by way of advance or loan to a shareholder, ...]

It was held that advance can only mean such advance which carries with it an obligation of repayment. A trade advance, which is in nature of money transacted to give effect to a commercial transaction, cannot be treated as 'deemed dividend' falling within ambit of provisions of section 2(22)(e). Rule of noscitur a sociis was applied.

15.2.11 Rule of 'Expressio Unius Est Exclusio Alterius' (Expression of one thing implies Exclusion of other Similar Things)

This rule means that where there are two mutually exclusive items, the inclusion of one would implicitly mean the exclusion of the other.

The above rules are the most basic rules of interpretation and the Courts use them along with certain Acts like the General Clauses Act, 1897 and the State General Clauses Act, to ascertain meanings of words not defined in the Act.

Roman vs. Terrell, 195 Ga. App.219 (1990)

When one thing is included in a statute, similar things not mentioned in the statute are deemed to be excluded.

Bailey vs. Lumpkin, 1 Ga.392, 403, 404 (1846)

If same things (of many) are expressly mentioned, the inference is stronger that those omitted are intended to be excluded than if none at all had been mentioned.

15.2.12 External aids to interpretation

The Court may also use certain external aids like works of prominent authors, dictionaries, legislative debates, etc., to interpret a statute correctly. Relevance of Finance Minister's speech to interpret tax statutes: The words of the statute do themselves best declare the intention of the law given. It is only if there is any ambiguity in the language, in understanding the intention of the Legislature, that the aid can be taken of the proceedings in the Parliament including the aims and objects of the Act. Section 57 of the Evidence Act not only enables but enjoins the duty upon the Courts to take judicial notice of the course of proceedings in the Parliament.

15.2.13 Generalia Specialibus Non Derogant : (General provisions must yield to the special provision)

Generally speaking, the sections in the Act do not overlap one another and each section deals only with the matter specified therein and goes no further. If a case appears to be governed by either of two

provisions, it is clearly the right of the assessee to claim that he should be assessed under the one, which leaves him with a lighter burden.

The literal meaning of the expression 'Generalia Specialibus Non Derogant' is that general words or things do not derogate from the special. The Courts have held the expression to mean that when there is a conflict between a general and special provision, the latter shall prevail as held in the cases of **CIT vs. Shahzada Nand and Sons** 60 ITR 392 (SC) and **UOI vs. Indian Fisheries (P.) Ltd.** AIR 1966 SC 35, or the general provisions must yield to the special provision.

Where there is a conflict between two statutes:
The general rule to be followed in case of a conflict between two statutes is that a later statute abrogates the earlier ('leges posteriors priores contrarias abrogant') and the well-known exception is that general legislations do not derogate special legislations.

Partnership Act vs. Income Tax Act: The above maxim was applied when the questions relating to assessments of a firm and its partners arose under the Income-tax Act, 1961 where the dissolution of the firm and its succession was held to be governed by the Special Act viz., the Income-tax Act and not the Partnership Act. The Karnataka High Court has held in the case of **CIT vs. Shambulal Nathalal & Co.** [1984] 145 ITR 329 (Kar.) that when the Legislature has deliberately made a specific provision to cover a particular situation, for the purpose of making an assessment of a firm under the Income-tax Act, there is no scope for importing the concept and the provisions of the Partnership Act. The legal position of a firm under the income-tax law is different from that under the general law of partnership in several respects.

Claim as Donation u/s 80G or Business Expenses u/s 37(1): In **Jaswant Trading Co. vs. CIT** 212 ITR 24 (Raj): 128 CTR 306: 85 Taxman 639 (Raj.) the Rajasthan High Court held that the provisions of section 37 are general in nature and the provisions of section 80G are specific. Applying the maxim generalia specialibus non derogant if an amount is liable for deduction under section 80G it cannot be claimed under the general provisions of section 37(1).

15.2.14 Mimansa Rules of Interpretation

If there are two possible interpretations of a rule, one which serves the object of a provision in the parent statute and the other, which does not, the former has to be adopted because adopting the latter

will make the rule ultra vires the Act. (b) The Act falls in the second layer in this hierarchy, the rules made under the Act fall in the third layer. Hence, if there is any conflict between the provisions of the Act and the provisions of the Rules, the former will prevail.

Rules and notification – Rules made under the Act have the same force as the sections in the Act. But no exercise of the rule-making power can affect control or detract from the full operative effect of the provisions of the sections. Any rule, which purports to do so, would be ultra vires and void. - Hukumchand Mills Ltd vs. State of MP 52 ITR 583, 589 (SC).

15.2.15 Miscellaneous

(a) Definition clause – In **CIT vs. The Hindu** 18 ITR 237, 250; **CIT vs. Srinivasan & Gopalan** 23 ITR 87 (SC) it was held that a definition or interpretation clause, which extends the meaning of a word, should not be construed as taking away its ordinary meaning. Further, such a clause should be so interpreted as not to destroy the basic concept or essential meaning of the expression defined, unless there are compelling words to the contrary.

(b) **Undefined words** – Words, which are not specifically defined, must be taken in their legal sense or their dictionary meaning or their popular or commercial sense as distinct from their scientific or technical meaning, unless a contrary intention appears.

(c) **Legal fiction** – In **CIT vs. Godavari Sugar Mills Ltd** 63 ITR 310, 315-6 (SC) it was held that the word "deemed" is apt to include the obvious, the uncertain and the impossible. A legal fiction has to be carried to its logical conclusion. However, in **CIT vs. Vadilal Lallubhai** 86 ITR 2, 8 (SC) it was held that the fiction operates only within the field of the definite purpose for which the fiction is created.

(d) **Marginal notes** – Marginal notes to the sections cannot control the construction of the statute – **CIT vs. Ahmedbhai Umarbhai** 18 ITR 472, 487 (SC); **Chandroji Rao vs. CIT** 77 ITR 743, 745-6 (SC)], but they may throw light on the intention of the legislature – **CIT vs. Vadilal Lallubhai** 86 ITR 2,11 (SC).

(e). **Punctuation** – Punctuation may assist in arriving at the correct construction of a statutory provision.

(f) **Retrospective effect of rules and notifications** – An authority cannot make rules or issue notifications adversely affecting the assessee's rights with retrospective effect, unless

the statute, whether expressly or by necessary intendment, empowers the authority to do so – **ITO vs. Ponnoose** [1970] 75 ITR 174 (SC). This principle received statutory recognition in section 295(4) w.e.f. 18.8.1974 inserted by Direct Taxes (Amendment) Act, 1974.

(g) **A completed assessment may be reopened or rectified** – A completed assessment may be reopened u/s 147 or rectified u/s 154 –**Venkatachalam vs. Bombay Dyeing & Manufacturing Co Ltd.** 34 ITR 143 (SC), if the relevant provisions of the law are amended with appropriate retrospective effect.

(h) **Necessity of speaking orders** - Where under the provisions of the Act an authority is empowered to grant approval or exemption, and the taxpayer has a right to claim it on fulfillment of the statutory conditions, the authority is bound to pass a speaking order and give reasons in support of its finding that the taxpayer is not entitled to the approval or exemption. The appellate and revisional authorities likewise must pass speaking orders. In fact Article 141 of the Constitution of India also mandates this.

(i) **Double taxation not permitted** – In **Jain Bros vs. Union of India** 77 ITR 107, 112 (SC) it has been broadly stated the principle of the Income-tax Act is to charge all income with tax, but in the hands of the same person only once. There could be double taxation if the legislature distinctly enacted it.

15.3 CHAPTER REVIEW

This chapter discusses the concept of interpretation of tax laws. The use of external aids like authors, land legislative debates, and other miscellaneous issues on statutes.

15.4 WORKED EXAMPLES

15.4.1 Questions

1(a) Explain briefly what you understand by "Ínterpretation of tax laws".

(b) Explain the rule of literal interpretation giving at least two decided cases.

(2) Explain the following:

(a) The Golden Rule

(b) Rule of Harmonious Construction

(c) The Doctrine of "Reading Down"

(3) (a) Explain the term "Ejusdem Generis" or "Noscitur a. Sociis"

(b) What are the effects of Marginal Notes in interpretation of tax laws?

(4) (a) Explain the term "Expressio Umus Est Exclusio Alterius".

(b) Explain the use of external aids to interpretation.

15.4.2 Suggested Solutions

1(a) In the interpretation of taxing statutes, there are principles on which the interpretation of a particular statute is done by the courts and legal practitioners and tax experts are expected to have the knowledge of the in order to understand the statutes and their implications.

These fundamental principles guide the judges in interpreting the laws and also in arriving at their decisions. L.J Denning in Seafood Court Estates v Asher (1949) 2 All ER 155 had this to say:

"A judge must not alter the material of which the Act is woven but he can and should iron out the creases. When a defect appears, a judge cannot simply fold his hands and blame the draftsman. He must set to work on the constructive task of finding the intention of the Parliament and then he must supplement the written words so as to give force and life to the intention of the legislature.

Also in FCT v Westraders Barwick CJ said: "It is for the parliament to specify and to do so, in my own opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax." The function of the court is to interprete and apply the language in which Parliament has specified in those circumstances. The court is to do so by determining the meaning of the words employed by the Parliament according to the intention of the Parliament, which is discoverable from the language used by the Parliament. It is not for the court to mould or attempt to mould the language.

Barwick to a strict literal approach to interpreting taxation legislation. Barwick approach were that taxes were penalties imposed by the state, which stood between citizens and their right to prosper from their enterprise. The tax laws could be construed in highly technical terms, without regard for the purpose they were designed to serve.

Justice Graham hills of the Australian High Court, his views as to the correct approach for a court to take in interpreting taxation legislation, made it clear that a court should adopt a purposive approach by applying the ordinary meanings of the words used to give effect to the legislative purpose behind the legislation. This approach requires looking to the context of the legislation in its widest sense to give effect to the objects of the legislation. However, such approach not be used to advance any personal theories of justice.

(b) **Cardinal Rules for interpretation of taxing statutes**

Rule of literal interpretation

(i) **CIT vs T.V. Sundaram Iyyengar (1975) 101 ITR 764 (SC)**

If the language of the statute is clear and unambiguous, Courts must give words their cannot discard the plain ordinary meaning, even if it leads to an injustice. Courts have no authority to place a different construction on it, even if it leads to an injustice. It must apply it according to its terms.

(ii) **CIT vs Elphinstone Spg & Wvg Mills Co. Ltd.** 40 ITR 142 (SC) and CIT vs Motors & General Stores Ltd. 66 ITR 692, 699-700 (SC).

No tax can be imposed on the subject without words in the Act clearly showing an intention to lay a burden upon him. In other words, the subject cannot be taxed unless he comes within the letter of the law. The argument that he falls within the spirit of the law cannot be available by the Department.

(iii) **City of Jesup vs. Bennett. 226. Ga.606 (1970)**

Where the language of an act is plain and unequivocal, judicial construction is not only unnecessary but is forbidden.

(iv) Rowlatt J. in **Cape Brandy Syndicate vs IRC** (1921) 1 KB 64 approved in **CIT vs Ajax Products Ltd.** (1965) 55 ITR 741 (SC).

"In a taxing Act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look at the language used." (p. 747).

Thus, when the language of a taxing statute is clear, if an assessee falls within the four corners of the statute, he is to be taxed; if not, no tax is to be levied.

(v) **Smt. Tarulata Shyam vs. CIT** (1971) 108 ITR 345 (SC). There is no scope for importing into the statute words which are not there. Such importation would be, not to construe, but to amend the statute. Even if there be a casus omissus, the defect can be remedied only by Legislation and not by judicial interpretation.

2(a) **Golden Rule (Doctrine of purposive construction)**

If the strict interpretation of the taxing statute is likely to lead to a manifest absurdity, then the golden rule of construction implies that the meaning of the words should be so effected that such an absurdity is avoided. The application of this rule is rather limited in the realm of construction of taxing statutes, since the literal rule would gain precedence over the golden rule and it is often remarked that equity and taxation are strangers – **Grey vs. Pearson** (1857) 6 HL 61, 106.

(b) **Rule of harmonious construction**

When any provision of a taxing statute is interpreted, it must be so constructed that the meaning of such provision must harmonise with the intention of the Legislature behind the provision in particular and the enactment in general – **CIT vs. Chandanben Maganlal** (2002) 120 Taxman 38 (Guj.). However, this would always be subject to the fact that the particular provision, or even the entire enactment, should not be held unconstitutional.

(c) **Doctrine of 'reading down'**

Resort to reading down is done where a legal provision; read literally, seems to offend the Constitutional provisions concerning fundamental rights or is found to be outside the competence of the particular Legislature. Some relevant decisions are given hereunder.

(i) **Sri Venkateshwara Timber Depot vs. Union of India** (1991) 189 ITR 741/155 Taxman 308 (Ori). The Court construes the provision in question in a limited sense to ensure that its meaning falls within the parameters of constitutionality or is intra vires the powers of the Legislature in question (generally in the case of State Legislatures).

(ii) **Arun Kumar vs. UOI** (2006) 155 Taxman 659 (SC) Reading down a provision is based on the premise that to sustain the law by interpretation is the rule. To add further, as held in **Kedar Nath Singh vs. State of Bihar** AIR 1962 SC 955.

"The Legislature is presumed to be aware of its limitations and is also attributed an intention not to overstep its limits."

3(a) **Rule of 'Ejusdem Generis' or Noscitur a Sociis**

The Rule is that the meaning of a general word is restricted by the special words appearing along with it. To illustrate:

Gore vs. State .79 Ga. App: 669 (1949)

When a statute includes general terms, following specific terms, the general terms are confined to the same kind as the specific term.

"If a man tells his wife to go to the market to buy vegetables, fruits, groceries and anything else she needs, the 'anything else' would be taken to mean food and grocery items due to the rule of ejusdem generis and not cosmetics or other feminine accessories."

Thus, the meaning of a word must be taken by the company it keeps (Rule of noscitur a sociis). In the case of **CIT vs. Raj Kumar** [2009] 181 Taxman 155 (Del.) regarding Deemed dividend under section 2(22)(e) of the Income-tax Act, 1961, the word 'advance', which appears in company of word 'loan' was interpreted. Section 2(22)(e) reads as "any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) [made after the 31st day of May, 1987, by way of advance or loan to a shareholder, ...]

It was held that advance can only mean such advance which carries with it an obligation of repayment. A trade advance, which is in nature of money transacted to give effect to a commercial transaction, cannot be treated as 'deemed dividend' falling within ambit of provisions of section 2(22)(e). Rule of noscitur a sociis was applied.

(b) **Marginal notes** – Marginal notes to the sections cannot control the construction of the statute – **CIT vs. Ahmedbhai Umarbhai** 18 ITR 472, 487 (SC); **Chandroji Rao vs. CIT** 77 ITR 743, 745-6 (SC)], but they may throw light on the intention of the legislature – **CIT vs. Vadilal Lallubhai** 86 ITR 2,11 (SC).

4(a) **Rule of 'Expressio Unius Est Exclusio Alterius' (Expression of one thing implies Exclusion of other Similar Things)**

This rule means that where there are two mutually exclusive items, the inclusion of one would implicitly mean the exclusion of the other.

The above rules are the most basic rules of interpretation and the Courts use them along with certain Acts like the General Clauses Act, 1897 and the State General Clauses Act, to ascertain meanings of words not defined in the Act.

Roman vs. Terrell, 195 Ga. App.219 (1990)

When one thing is included in a statute, similar things not mentioned in the statute are deemed to be excluded.

Bailey vs. Lumpkin, 1 Ga.392, 403, 404 (1846)

If same things (of many) are expressly mentioned, the inference is stronger that those omitted are intended to be excluded than if none at all had been mentioned.

(b) **External aids to interpretation**

The Court may also use certain external aids like works of prominent authors, dictionaries, legislative debates, etc., to interpret a statute correctly. Relevance of Finance Minister's speech to interpret tax statutes: The words of the statute do themselves best declare the intention of the law given. It is only if there is any ambiguity in the language, in understanding the intention of the Legislature that the aid can be taken of the proceedings in the Parliament including the aims and objects of the Act. Section 57 of the Evidence Act not only enables but enjoins the duty upon the Courts to take judicial notice of the course of proceedings in the Parliament.

APPENDICES

APPENDIX I

GLOSSARY OF TERMS

Adjusted Profit (under PPT)

The adjusted profit of an accounting period in respect of a company engaged in petroleum operations shall be the profits of that period after the deductions of allowable expenditures and any adjustments necessary to exclude the profit or loss attributable to transportation operations which is assessable under Companies Income Tax Act (CITA).

Agricultural trade or business

Agricultural trade or business is defined in the Act as any trade or business connected with: the establishment or management of plantations for the production of rubber, oil palm, coffee, tea and similar crops: the cultivation or production of cereal crops, tubers, fruits of all kinds, cotton, beans, groundnuts, sheanuts, beniseed, vegetables, pineapples, bananas and plantains, animal husbandry, that is to say, poultry, piggery, cattle-rearing, fish farming, and deep sea fish-trawling".

Aggregate Demand

Aggregate demand is the relationship between the real quantity of newly produced goods and services purchased in the economy and the general price level.

Aggregate Supply

Aggregate supply is the relationship between the quantity of real national output that businesses are willing to produce and the general price level.

API

API is a unit of specific gravity measurement approved by the American Petroleum Institute. The American Petroleum Institute was established in 1920.

Associated Gas

Gas produced in the course of crude oil production is described as associated gas. Such gas is flared by most of the oil producing companies in Nigeria today.

Assessable profit (under PPT)

The assessable profit in respect of a company engaged in petroleum operations shall be the adjusted profit of the period after deduction of Education Tax, and after adjusting for the effect of any loss relief available to the company.

Balanced Budget

The nation's budget is said to be balanced when the expected revenue is expected to be the same as the expected expenditure for the fiscal year.

Barrel

A measure representing 35 imperial gallons or 42 U.S. gallons.

Board

The Federal Inland Revenue Service Board.

Capital Allowance

This is the tax relief that is granted to a trade or business on capital expenditure purchased and used in the production of the income instead of the depreciation of fixed assets charged in the financial statements.

Casing-head Gas

Natural gas that is produced in association with oil; the term usually applies to gas when it is first separated from crude oil.

Chargeable profits

The chargeable profits of a company engaged in petroleum operations shall be the assessable profits less capital allowances. For this purpose the amount of capital allowances to be deducted is to be restricted to the lower of –

(a) the amount computed or

(b) a sum equal to eighty-five percent of the assessable profits of theaccounting period less one hundred and seventy percent of the total amount of the deductions allowed as investment tax credit or petroleum investment allowance computed under the second schedule for that period. (Investment Tax Credit if the computation is for a company operating a Profit Sharing Contract as provided in the Deep Offshore and Inland Basin Production Sharing Contract Decree 9 of 1999. Petroleum Investment Allowance in other cases).

Commercialisation

Commercialisation involves the adoption of commercial, competitive and profit objectives in the management of public enterprises. It involves the jettisoning of socialist and monopolistic objectives that characterised the operation of public enterprises in the past.

Commonwealth tax

For double taxation relief purposes, the tax payable in the foreign country is referred to as Commonwealth Income tax. This is defined as any tax on income or profits of

companies charged under a law in force in any country within the Commonwealth or in the Republic of Ireland which provides for relief from tax charged both in that country and Nigeria .

Company

Any body corporate incorporated under any law in force in Nigeria or elsewhere.

Concession

Includes an oil exploration licence, an oil prospecting licence, an oil mining lease, any right, title or interest in or to petroleum oil in the ground and any option of acquiring any such right, title or interest;

Connected persons

In tax practice, certain people are treated as being so closely involved with each other that they have to be viewed as the same person or that transactions between them need to be treated differently from transactions 'at arm's length'. These people are referred to as 'connected persons'. Transactions between such people are treated as artificial or fictitious for the purpose of determining the tax liability arising therefrom.

Crude oil

Any oil (other than oil extracted by destructive distillation from coal, bituminous shales, or other stratified deposits) won in Nigeria either in its natural state or after the extraction of water, sand or other foreign substance therefrom but before any such oil is refined or otherwise treated.

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 the returns submitted to the tax office are subject to this audit.

Development Costs

Development costs are incurred to obtain access to proved reserves and to provide facilities for extracting, gathering, treating, and storing the oil and gas.

Direct Taxes

These are charged on a taxpayer's income, profits or other gains. They are paid by the taxpayer directly to the tax authority.

Downstream Operations

All activities of companies that are not caught under the definition of "petroleum operations" are referred to as downstream operations. Examples of downstream operations are petroleum refining, petroleum marketing and gas utilisation projects.

Companies engaged in downstream operations are subject to tax under the Companies Income Tax Act Cap C21 LFN 2004.

Dry Hole

A hole that was drilled but from which oil or natural gas was not found in commercial quantity.

Exploration and Drilling Costs

Exploration and Appraisal costs are costs incurred in the search for oil and gas deposits after obtaining a licence but before a decision is taken to develop a reservoir.

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 objective is to ensure that taxpayers pay correct tax.

Final and Conclusive Assessment

An assessment which has become final and conclusive cannot be reopened without the discovery of new facts. An assessment becomes final and conclusive under the following conditions:

(a) where no valid objection is made within the statutory time limit of 30 days from the date of the service of the notice of assessment;

(b) where an appeal against the decision of the Board is not made to the Body of Appeal Commissioners within 30 days from the date of the Notice of Refusal to Amend;

(c) where an appeal is not made to the Federal High Court within 30 days from the date of the decision of the Body of Appeal Commissioners.

Foreign Company

A foreign company (non-Nigerian company) is defined as any company or corporation established by or under any law in force in any territory or country outside Nigeria, that is a company that is not incorporated under the Companies and Allied Matters Act 1990.

Foreign tax

Foreign tax means any tax payable in a country which under a double taxation agreement is to be allowed as a credit against tax payable in respect of those profits in Nigeria.

Income Tax Acts

"Income Tax Acts" represent the Personal Income Tax Decree 1993; the Companies Income Tax Act or the Petroleum Profits Tax Act together with all applicable amendments to date.

Indirect Taxes

Indirect taxes are taxes on spending. The tax is charged when a taxpayer buys an item and is paid to the supplier as part of the purchase price of the item. The supplier passes the tax to the tax authorities.

Intangible drilling costs

All expenditure for labour, fuel, repairs, maintenance, hauling, and supplies and materials (not being supplies and materials for well cement, casing or other well fixtures) which are for or incidental to drilling, cleaning, deepening or completing wells or the preparation thereof incurred in respect of –

(a) determination of well locations, geological studies and topographical and geographical surveys preparatory to drilling.

(b) drilling, shooting, testing and cleaning wells

(c) cleaning, draining and leveling land, road-building and the laying of foundations, erection of rigs and tankage assembly and installation of pipelines and other plant and equipment required in the preparation of drilling of wells producing petroleum

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.

Lease

Includes an agreement for a lease where the term to be covered by the lease has begun, any tenancy and any agreement for the letting or hiring out of an asset, but does not include a mortgage, and all cognate expressions including "leasehold interest" shall be construed accordingly.

Liquefied natural gas

Natural gas in its liquid state at approximately atmospheric pressure.

Market Value

Market value in relation to any assets for capital gains tax purposes means the prices which those assets might reasonably be expected to fetch on a sale in the open market

Material Date

(a) in relation to a pioneer company engaged in a pioneer industry consisting of the provision of services, the date on which the company is ready to provide such services on a commercial scale; and

(b) in case of manufacturing, processing, mining, agricultural or any other pioneer industry, the date on which the company begins to produce a pioneer product in marketable quantities.

Mineral Rights Acquisition Costs

Mineral rights acquisition costs are the costs of acquiring concession rights in a lease area. They include the costs of:
Oil Prospecting Licence (OPL); (to search for oil)
Oil Exploration Licence (OEL); (to explore for petroleum)
Oil Mining Lease (OML); (to win, work, carry away and dispose of petroleum)
Bonuses and options to purchase or lease properties;
Minerals, when land, including mineral rights is purchased; and
Recording fees, legal costs and other costs incurred in acquiring properties

MMcf

One million cubic feet.

Natural gas

Gas obtained in Nigeria from bore holes and wells and consisting primarily of hydrocarbons.

Nigeria

Includes the submarine areas beneath the territorial waters of Nigeria and the submarine areas beneath any other waters which are or at any time shall in respect of mines and minerals become subject to the legislative competence of the National Assembly.

Nigerian Company

A Nigerian company is defined as one incorporated under the Companies and Allied Matters Act 1990, or any enactment replaced by that Act.

Non-associated Gas

Non-associated gas is that which can be produced independently of crude oil production. Nigeria is reported to have large quantity of Non-associated gas reserve. Such gas reserves may or may not include any amount of crude oil.

Non-productive rents

The amount of any rent as to which there is provision for its deduction from the amount of any royalties under an oil prospecting licence or oil mining lease, to the extent that such rent is not so deducted.

Oil Mining Lease

A lease granted to a company under the Minerals Act, for the purpose of winning petroleum, or any assignment of such lease.

Oil Prospecting Licence (OPL)

A licence granted to a company under the Minerals Act, for the purpose of winning petroleum, or any assignment of such licence.

Posted price

Posted price in relation to any crude oil exported from Nigeria by a company means the price f.o.b. at the Nigerian port of export for crude oil of the gravity and quality in question which is from time to time established by the company, after agreement with the Government of Nigeria as to the procedure to be followed for the purpose as its posted price for Nigerian crude oil of that gravity and quality (Section 21(5)).

Petroleum

Any mineral oil or relative hydro-carbon and natural gas existing in its natural condition in Nigeria, but does not include liquified natural gas, coal, bituminous shales or other stratified deposits from which oil can be extracted by destructive distillation.

Petroleum operations

Petroleum operations essentially involve petroleum exploration, development, production and sale of crude oil and gas.

Pioneer Conditions

Where the National Council of Ministers (the council) is satisfied that –

(a) any industry is not being carried on in Nigeria on a scale suitable to the economic requirements of Nigeria or at all, or there are favourable prospects of further development in Nigeria of any industry; or

(b) it is expedient in the public interest to encourage the development or establishment of any industry in Nigeria by declaring the industry to be a pioneer industry and any product of the industry to be a pioneer product, the council may declare such industries as pioneer industries and their products as pioneer products.

Pioneer Status

A company that has been issued a pioneer certificate has pioneer status. Such company shall be on a tax holiday for the period stated on the certificate. The profits earned by the pioneer company during its tax holiday are tax exempt. So also is the dividend declared out of such profits.

Production Costs

Production costs are the recurrent costs incurred in oil and gas production activities. Production involves lifting the oil and gas to the surface, gathering, treating, field processing and storage. Production costs are usually determined to be all costs incurred

from the maintenance of the wells and well heads to the storage facilities when the oil and gas are ready for export or delivery to a refinery.

Production Day

Production day of a pioneer company is the date certified for a pioneer company on which the period of the tax holiday of the company shall commence.

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 the operator who would later be reimbursed as provided for in the respective contracts.

Privatisation

Privatisation can be defined as the sale, transfer or removal of ownership and control from public to private entities in respect of state enterprises.

Qualifying expenditure

Capital expenditure incurred in a basis period that is qualified for the grant of capital allowances.

Resident in Nigeria

In relation to a company, means a company the control and management of the business of which are exercised in Nigeria.

Residue of qualifying expenditure

Companies chargeable under PPTA

The residue of qualifying expenditure, in respect of any asset, at any date, is the total qualifying expenditure incurred less the total of annual allowances granted to that date in respect of the asset.

It should be noted that the amount for Petroleum Investment Allowance is not to be deducted from qualifying expenditure in arriving at the residue

Companies chargeable under CITA

The residue of qualifying expenditure, in respect of an asset, at any date, is the total qualifying expenditure incurred less the total of initial and annual allowances granted to that date in respect of the asset.

Royalties

(a) The amount of any rent as to which there is provision for its deduction from the amount of any royalties under an oil prospecting licence or oil mining lease to the extent that such rent is so deducted; and

(b) The amount of any royalties payable under any such licence or lease less any such rent deducted from those royalties.

Tax Avoidance

Tax avoidance arises in a situation where the taxpayer arranges his financial affairs in a form that would make him pay the least possible amount of tax without breaking the law.

Tax Evasion

Tax evasion is an act whereby the taxpayer can achieve the minimisation of tax through illegal means. Tax evasion involves outright fraud and deceit, for example through deliberate omission of a source of the taxpayer's income from his return or deliberate understatement of any income.

Upstream Operations

All activities in respect of crude oil and gas production that fit into the definition of petroleum operations that are to be taxed under the Petroleum Profits Tax Act are referred to as Upstream operation.

APPENDIX II

STUDY AND EXAMINATION TECHNIQUES

This appendix contains notes on:
(a) Using the questions and answers provided in the manual;
(b) Effective study; and
(c) Examination technique.

2.1 *Questions and answers*

1. These questions are either
   (a) Questions intended to test the understanding of the points arising out of the particular Chapter; or
   (b) Examination questions inserted at a stage where it is considered the student will be best able to give a reasonable answer.
2. Most answers are given in outline, but some examination answers go a little further, in order to provide greater guidance and provide students with the basis for study.
3. When answers are *comprehensive,* you could not be expected to write them in the time allowed. *Do not* worry, if you feel you cannot write such answers; you are not expected to. But you *must* grasp the main points or principles involved, which will form the basis for good marks in an examination.
4. Do not worry, if your answer differs, there is often more than one approach. You must satisfy yourself however, that it is *only* the approach that differs, and that you have not missed the fundamental principles.
5. Authors' Comments. These have been included, to give *additional* points or elaborate on matters arising out of the subject covered by the question, to which it is felt, you should give some thought.

Using the answers

6. Have a shot at each question yourself, *before* consulting the answer, you will achieve nothing if you do not do this. Write your answer out in full or jot down the main points. *Do not* hurry to the answer.
7. Look at the answer. (See para 5 in the case of examination answers). Study the particular area *thoroughly* now, making sure of your understanding. *Repeat* the process outlined in para 7and this paragraph, after a suitable interval. You *must* do this, to get any benefit at all. Make sure the main points *stick.*
9. Just browsing through the answers will really get you *nowhere.* You *must* test yourself, by *writing* down your version of the answer.

2.2 *Effective study*

Introduction

1. These notes are intended for those who are new to studying for examination subjects, although those who are not may also benefit. They

have been written in relation to study, involving the reading of *textbooks*, and they apply to *all* subjects. It is often very difficult to pick out the important principles from such books. Careful reading of these notes, will be of benefit even in studying the manual.

General

2. Study, means more than *just reading* a piece of literature. It means, *close concentrated reading,* with a *notebook* at your side. Unless you are one of a *few* people who can absorb material by *just one* general read through it, do not kid yourself.
3. Read a small area, *making notes* as you go along. Then ask yourself – "what have I just learnt?" *Write* down what you think it was all about. Then look again and you may be surprised to find you have missed a *key* point or points – they *must* be down in your notebook and eventually in your head.

Compilation of notebook

4. A *well-compiled* NOTEBOOK is a must. Use block capitals or different colour inks, to *headline* the main areas and subdivisions of those areas. Notes made during lectures or private study, should *not* go straight into your NOTEBOOK. Take them down on a "rough" paper and write them in your NOTEBOOK, *as soon as possible* after the lecture or study period, thinking about what you are writing.

Memory aids

5. **Mnemonics** are very useful – if the sequence of points in the textbook *is not* significant, *change it* if it makes for a better mnemonic.
6. **Association** of the points with familiar objects, which will serve to recall them, is also useful.
7. Some people memorise things by *saying* them over and over *out loud*, others have to *write* them down *time* after *time.*
8. Many students have *small blank cards* and using one side of each card for each study area, put down the main points. They carry the cards everywhere with them and use every opportunity to study them. As they are small they are easily carried. It is surprising how much of your day can be utilised this way.

Programme

9. Map out a programme for yourself; set targets and *achieve* them. One thing is certain, studying is not easy, but it is *not* too difficult, if you go about it in an orderly purposeful way. Many students fail their examinations through bad preparation. Tackle your studies as you would a project at work, systematically. Allocate a number of hours each week to each subject. Try fixing specific times for each subject, then keep to them, by refusing to let anything keep you from your planned task.

Revision

10. Revise periodically. The nearer the examination gets, the more you should concentrate on the major headlines in your notebook and less with the supporting details.

2.3 *Examination technique*

First impressions

1. However well prepared you may be, you are still likely to look at the paper on the day and say to yourself, after a quick look at the questions, "There's not much *here* I can do".
2. The atmosphere of the exam room has something to do with this. Try to blot everything from your mind, other than the job in hand. *Concentrate* hard. If you feel a bit panicky (most people do – despite the apparent looks of serenity around you) grip the table, take a deep breath, and *get on with it.* Remember things are *never* as bad as they seem!

Time allocation

3. *Allocate* each question *time* appropriate to the number of marks after first setting aside 15 - 20 minutes (of a 3 hour paper say), for initial reading of the questions, and final review of your answers. At the end of the allotted time for a question, *go on to the next* – remember, the *first* 5 or 10 marks on the *new* question are more readily picked up than the *last* 1 or 2 on the *previous* question.
4. The *temptation* will be to say "I'll write just *one* more sentence", but before you know where you are, you would have written *several* more and probably just managed to scrape another mark, whereas the same time on the next question, could have earned 5 or 6 marks. TIME ALLOCATION IS IMPORTANT.
5. Always leave some writing space, between your answers to each question, as you move on, because you may recall part of the answers to earlier questions, as you answer latter questions. Then you can quietly go back to update in the space reserved.
6. If you *are* running out of time write down the *main headings first,* leaving a few lines between each – at least the examiner will see that you had the overall picture. *Then* go back putting in as much supporting detail as you can.

General approach

7. Read the *instructions* at the top of the paper
8. Read the question paper once through. Make your choice of questions quickly. Pick the easiest (if one appears so) and *get on with it.*

Individual question

9. Read the question again carefully. The question will involve a key principle or set of principles. What are they? It is so easy to make the

wrong decision at this stage, so read the question, underlining what appear to be the *key words.* This should help you. Irrelevancy has been heavily critcised by examiners.

10. Do not rush into action with your pen *yet.* Jot down on a piece of scrap paper, the *main headings* you will use in your answer. All this will take time – about 5 minutes or more, but the *careful thought* and outline answer represent *marks* already earned.
11. If the question is *set* out in a particular sequence, that is:

    a. ....

    b. ....

    c. ....etc.

    then answer it *in that sequence* or you'll have a *hostile examiner* to cope with.
12. Use the particular terminology *used in the question*, the examiner can then *link the points* in your answer, to the relevant parts of the question.
13. Assumptions are sometimes required (for example because of the lack of standardisation of terminology in this subject). Having stated your assumptions, make sure that what you write is *consistent* with them. Do ensure, however, that

    your assumptions *are valid* and are *not* just a device for changing the *meaning* of the question to suit your knowledge!
14. Tabulate where appropriate, using block capitals, for your main headings and underline subheadings. Underline *words* or phrases which require emphasis. *Use a ruler.*
15. Leave a line *between* your paragraphs and subparagraphs. This makes for a *good* layout. However, do *not* write one very other line within paragraphs, or on one side of the paper only – examiners are waste conscious!
16. Write out each word clearly, don't forget you are not the examiner reading your answers. In your hurry, be legible.

Layout of Answers

17. Tabulate where appropriate, using block capitals, for your main headings and underline subheadings. Underline *words* or phrases which require emphasis. *Use a ruler.*
18. Leave a line *between* your paragraphs and subparagraphs. This makes for a *good* layout. However, do *not* write on every other line within paragraphs, or on one side of the paper only - examiners are waste conscious!
19. The use of different colour pens, where appropriate, is useful but do not overdo it. In fact one black and red felt-tip pen would be sufficient (use the felt-tip pens which have a *fine point*).

Charts and diagrams

20. A descriptive heading or title must be given to each diagram (using the one in the question if indicated).
21. Do not squeeze a diagram into a corner – *spread it out.*
22. Do not clutter your diagram up with too much detail – this defeats the object, which should be clarity.
23. Give a *key* to the symbols and the different lines you've used, and again – use a ruler.

End of examination procedure

24. Have a quick look at each answer, checking for grammatical errors and badly formed letters.
25. Ensure each answer sheet has your *number* on it and *do not* leave any lying on the table.

Conclusion

26 Good technique plays a *large* part in examination success; this is a *fact. Refuse* to be panicked, keep your head, and with reasonable preparation you *should* make it.

27 Remember – you do not have to score *100%* to pass.

28 A final point; once you're in the examination room, *stay there* and make use of every minute at your disposal.

29 Practice your technique, when answering the questions set in the manual.

APPENDIX III

DECIDED TAX CASES

COMMISSIONER OF INCOME TAX....................RESPONDENT

V

NIGERIAN PROPERTIES CO. LTD. .... APPELLANT

SUPREME COURT, LAGOS

(BUTLER LLOYD, J.)

AUGUST 16, 1940

Companies Income Tax — Purchase of Mining Right for a Term of Years — Whether the Sum Used to Purchase Mining Right was Deductible from Chargeable Income of the Company on Annual Basis — Whether Mining Right was a Fixed or Circulating Capital.

The appellant, a company incorporated in Nigeria, bought (with share capital issued for the purpose) certain mining rights for the sum of 516,695 pounds. The mining right had sixty-three years to run, and the appellant decided to make a yearly allocation from the receipts of Accounting Periodroyalties of the mining right for the amortisation of the expenditure on their purchase.

The appellant claimed that these allocations should be allowed as deductions under Section 11 of the Income Tax Ordinance, 1940 in ascertaining its chargeable income. The respondent disallowed one of such deductions and included it in the chargeable income on which an assessment was made. It was contended by the respondent that the deduction should not be made from royalties under the Ordinance.

HELD

The annual allocations from the receipt of the mining right for the amortisation of the expenditure of its purchase were allowable under Section 11 of the Ordinance. The mining right in question should be regarded as floating or circulating and not fixed capital.

CASE REFERRED TO:

1. Golden Horse Shoe (New), Ltd. v Thurgood (1934) 1 K.B. 548

OFFSHORE INTERNATIONAL S.A. .... PLAINTIFF

V

FEDERAL BOARD OF INLAND REVENUE .... DEFENDANT

FEDERAL REVENUE COURT, LAGOS

(J. OMO-EBOH, J.)

JUNE 7, 1976

Companies Income Tax — Liability of Foreign Company to Nigerian Tax — Contract Agreement to Drill Oil Well in Nigeria — Whether Foreign Company was carrying on Trade or Business in Nigeria — Whether Taxpayer could seek a Declaratory Judgement of Non-liability to tax where Tax Assessment had already been raised.

The Plaintiff was a company incorporated in Panama and its principal office was in Houston, Texas, USA. It had no place of business in Nigeria but it had a wholly owned subsidiary company in Nigeria called International Drilling Company (Nigeria) Limited ("IDC").

The plaintiff entered into various contractual agreements with some Nigerian Oil Companies, namely; Shell-BP, Mobil Oil, Japan Petroleum Company, etc. to carry out certain oil well drilling and completion operations in Nigeria. Under the agreement, substantial payments were made to the plaintiff between 1972 and 1975. The payments were made in United States and in US dollars. The plaintiff, however, subcontracted the parts of the contracts that were carried out within Nigeria to its subsidiary company, IDC.

The defendant was of the opinion that the plaintiff was liable to income tax in respect of the payments received on the contracts, and consequently wrote a letter to the plaintiff to demand for completion of the tax forms and the statements of accounts for the relevant years. The plaintiff neither completed the forms nor sent the accounts. After the expiration of the period of sending the statements of accounts, the defendant assessed the plaintiff to tax for the total sum of ₦162,912, under the Companies Income Tax Act, 1961.

Dissatisfied with the action, the plaintiff instituted this proceeding against the defendant to seek a declaratory judgment that it was not liable to tax under the Companies Income Tax Act, 1961 and that it was not under any obligation to furnish its statements of accounts or complete the tax forms as demanded by the defendant.

The plaintiff further sought an injunction to restrain the defendant from taking steps to enforce compliance with its demands. The plaintiff contended as follows:

(1) That it was not a Accounting PeriodNigerian company and that it had no place of business in Nigeria.

(2) That the parts of the contracts performed by the plaintiff were executed outside Nigeria and the parts that were executed in Nigeria were subcontracted to IDC. That the plaintiff hired out oil rigs and other equipment to IDC for the purpose of the contracts, and that the maintenance and repair of the equipment were the responsibility of IDC;

(3) That by the contact agreement, the plaintiff was paid in United States and in dollars; and

(4) That the plaintiff was not doing business in Nigeria and was, therefore, not liable to tax in Nigeria.

The contentions of the defendant were as follows:

(1) That the plaintiff was liable to tax in Nigeria having obtained contracts in Nigeria;

(2) That the defendant rightly assessed the plaintiff to tax, and as the plaintiff had refused to object to the assessments, the assessments had become final and conclusive;

(3) That the plaintiff was not competent to seek a declaratory judgement of non-liability to tax after an assessment had been made and that the only remedy available to the plaintiff was to appeal against the assessment;

(4) That IDC was an agent of the plaintiff and that although IDC might be liable to pay tax, the plaintiff was equally liable under Section 17 of the Companies Income Tax Act, 1961;

(5) That there was no distinction between Nigerian and foreign companies on the question of liability to Nigerian taxes; and

(6) That it was the plaintiff which derived all the profits of the contracts obtained in Nigeria and not IDC.

HELD:

(1) That the plaintiff was entitled to a declaratory judgment of non-liability to tax if it could show that it was a Accounting Periodforeign company and that it had got no profits accruing in or derived from Nigeria in respect of Accounting Periodtrade or business;

(2) That there was no section in the Companies Income Tax Act, 1961 which conferred exemption or immunity from payment of tax to a company because it was not incorporated in or resident within Nigeria or because it had no office or place of business in Nigeria; and

(3) By evidence tendered by the plaintiff, it was clear that the plaintiff entered into contracts to drill oil wells in Nigeria for various Nigerian oil companies. The plaintiff was, therefore, engaged in Accounting Periodtrade or business in Nigeria and was liable to tax in Nigeria. The fact that the plaintiff chose to perform part of its own side of the contracts by subcontracting to its own subsidiary could not remove its liability to tax in Nigeria.

CASES REFERRED TO

1. M.C. Aboud V Regional Tax Board (1966) NMLR 100; (1996) All NLR 45
2. Alhaji A. Agbaje and Others V Chiefs S. Agboluaje and Others (1970) 1 All NLR 21
3. Ikebife Igbineweka and Others V Peter Egbuna and Another (1964) 1 W.L.R. 219
4. Grainge and Sons V Gough 3 Tax cases 462
5. Nielsen, Anderson and Collings 13 Tax Cases 91
6. Tern V Scalan 13 Tax Cases 91
7. Belfour V Mace 13 Tax Cases 539
8. Salomon V Salomon (1897) A.C. 22
9. Smith, Stone and Knight V Birmingham Corporation (1939) 4 All ER, 116
10. F.G. Films Ltd. (1953) 1 WLR483
11. Bank Voor Handel En Scheepvaart NV V Slatford (1953) Q.B. 248
12. Diab Nasir V Federal Board of Inland Revenue (1964) 1 All NLR 408
13. Federal Commissioner of Taxation V Clarke 40 Commonwealth L.R. 246

E.A. AJAYI .... APPELLANT

V

FEDERAL BOARD OF INLAND REVENUE .... RESPONDENT

HIGH COURT, LAGOS (TAYLOR, J.)

JANUARY 18, 1971

Personal Income Tax — Conditions for Adjournment of Cases before the Body of Appeal Commissioners — Whether record of proceedings of the Appeal Commissioners should be sent to the Court of Appeal.

The appellant appealed against the decision of the Body of Appeal Commissioners which dismissed his appeal on the ground that he was neither present nor represented at the hearing. The Body of Appeal Commissioners had earlier granted an adjournment of the hearing on conditions that the appellant paid 500 pounds deposit, and that no further adjournment would be granted if the appellant failed to appear on the date of adjournment. The case was then dismissed by the Appeal Commissioners.

On appeal to the high court, the respondent failed to give the record of Proceedings from the Appeal Commissioners contending that the Income Tax Appeals (Lagos) Rules 1957 did not make provision for sending record of proceedings in income tax matters to the court.

HELD

1. Under Section 40(c) of the Personal Income Tax Act, 1961 the Appeal Commissioners were empowered to make orders for payment of deposit before granting an adjournment, but the Act did not empower the Appeal Commissioners to make any additional condition to that of making a deposit;
2. No appeal could be properly heard without a certified true copy of the proceedings before the lower court being made available to the court of appeal; and
3. Appeal upheld. Fresh hearing ordered.

LEGISLATION CONSIDERED

1. Personal Income Tax (Lagos) Act, 1961 Section 40
2. Companies Income Tax Act, 1961 Sections 56, 57(9)

JUDGMENT

(By J.I.C. Taylor, C.J.)

The present appellant Accounting Periodappeals from the decision of the Body of Appeal Commissioners.

MOBIL OIL NIG. LTD .... APPELLANT

V

FEDERAL BOARD OF INLAND REVENUE .... RESPONDENT

SUPREME COURT OF NIGERIA, LAGOS

(FATAYI-WILLIAMS, MADARIKAN, BELLO, J.J. SC.)

MARCH 31, 1977

(CASE 2)

Companies Income Tax — Additional Tax Based on Turnover — Whether Tax Authority had Power to Assess on Turnover after an Initial Assessment based on Accounts Submitted — Meaning of the word, 'Discover' — Whether it was necessary to discover new facts before assessments which had

become final and conclusive could be reopened — Whether Revenue Court had power to substitute one Rate of Assessment for another Rate

The appellant was originally assessed to tax for 1968/69 and 1969/70 years of assessment under Section 49 of the Companies Income Tax Act, 1961 based on the accounts submitted to the respondent. The appellant paid the assessed taxes.

The respondent subsequently raised Accounting Periodadditional assessments on the appellant under Section 30A of the Act based on 10 per cent of the turnover of the accounts submitted. The additional assessments were raised because the respondent was of the opinion that the rates of profits declared in the accounts were less than expected from the business carried on by the appellant.

The appellant appealed to the Body of Appeal Commissioners, which dismissed the appeal and upheld the additional assessments. On further appeal to the Federal Revenue Court, the rate of the assessment was reduced from 10 per cent to 8 per cent as the court was of the opinion that the respondent took extraneous matters into consideration in raising the additional assessments.

The appellants further appealed to the Supreme Court and contended, inter alia, as follows:

(1) That having assessed the appellant under Section 49 of the Act, the assessments as computed had become final and conclusive by virtue of Section 60, of the Act;

(2) That the respondent had no jurisdiction to raise additional assessments unless there was evidence of discovery of new fact to reopen the assessments by virtue of Section 50 of the Act; and as no new fact was discovered the finality and conclusiveness of the assessments were absolute;

(3) That Section 30A of the Act could be invoked where the Accounting Periodassessable profits of the company could not be ascertained or where the profits of the accounts were less than expected from the business carried on by the company; but as the profits shown by the accounts of the appellants were not less than expected to arise from the business considering the prevailing circumstances, the turnover assessment under Section 30A of the Act should not apply; and

(4) That the Federal Revenue Court had no power to substitute one rate of assessment for another; instead the proper order to make was to reject the assessments as computed having found that the respondent took extraneous matters into consideration in making the assessments.

The respondent replied, among other things as follows:

(1) That the Act conferred a discretion on the respondent to assess on the basis of assessable profit under Section 49 or on the basis of turnover under Section 30A where the taxpayer made profits which were lower than expected from its business; and

(2) That there was no provision in the Act which required the discovery of a new fact before an Accounting Periodadditional assessment could be validly raised under Section 50, and that subject to the limitation imposed by Section 60 of the Act, the respondent had power to make additional assessments whether there was a new fact or not.

HELD

(Fatayi-Williams Dissenting)

(1) The word, 'discover' simply means 'find out', and that either 'new facts' or 'new issues' could be discovered to necessitate reopening an assessment under Section 50 of the Act;

(2) The discovery by the respondent that the appellant made assessable profits which were lower than expected to arise from its business was a discovery of "new issue" within the meaning of the Act, and the discovery justified making additional assessments under Section 50;

(3) The finality and conclusiveness of an assessment under Section 60 of the Act were restricted to the amount of total profits as agreed to, or determined on objection, revision or appeal. The Act did not prevent the respondent from making an assessment or additional assessment on discovery of new facts or new issues; and

(4) The Federal Revenue Court had power under Sections 27 and 28 of the Federal Revenue Court Decree, 1973 to vary the judgment or order of the Body of Appeal Commissioners.

GODSON OKOLI .... APPELLANT

V

COMMISSIONER OF INTERNAL REVENUE,

EASTERN REGION .... RESPONDENT

HIGH COURT, ENUGU (PALMER AG. J.)

OCTOBER 2, 1958

SUPREME COURT OF NIGERIA, LAGOS (ADEMOLA, C.J.)

OCTOBER 31, 1960

Personal Income Tax — Whether an Appeal was made out of Time — Income Received on Behalf of a Company — Effect of Failure of Taxpayer to produce sufficient evidence of Income of Company.

The appellant received 2,855 pounds commission from UAC Nigeria limited as a servant of a company known as "The Produce and General Service Company". He did not produce sufficient evidence of the other income of the said Company and neither did he produce the bank account of the Company. The commission was, therefore, deemed to be part of the personal income of the appellant.

The appellant was personally assessed to tax on the commission received from UAC Nig. Ltd. on an assessment notice dated 15, March, 1958, but it was released to the appellant on the 23 June, 1958. There was an alteration of the date to 23 June on the assessment notice but the circumstances of the alteration was not made clear to the Court.

The respondent contended that as the proper date of the assessment notice was 15 March, the appeal was time barred. The appellant contended that as the assessment notice was released to him on the 23 June, and no fixed date of payment appeared on the notice, it was not time barred.

HELD:

1. The appeal was not time barred as it was released 3 months after it was written to the appellant, and no fixed date of payment appeared on the notice;
2. Since the appellant did not give sufficient evidence of income of the company on behalf of which he received the income, he had not discharged the onus of proof of his income; and
3. Appeal dismissed.

JUDGMENT

(By Palmer, Ag. J.)

The first point for consideration is whether the appeal is time barred. The notice of assessment was dated 15 March, 1958 and the date for payment was 21 March. The date of the notice (15 March) has been altered to 23 June, 1958 and there is a conflict of evidence as to the circumstances in which this was done. It may well be that the appellant misunderstood what the Assessment Officer (Mr. St. Leger) told him. As the notice was apparently reAccounting Periodleased on 23 June and no fixed date for payment appears on the notice, I do not think I can hold that the appellant had clear notice of the date by which he was to pay. That being so, I cannot say that his notice of appeal was out of time.

The substantial point at issue is this. Admittedly the appellant received 2,854 pounds commission from UAC. His care is that he received this simply as the servant of a firm known as "The Produce and General Service Company" to whom the money was paid. The appellant produced a certificate showing the registration of a business name in 199. He produced a book showing the names of the partners — it does not even show the name of the firm. Pay sheets are produced for employees at Nsukka, they do not show the name of the firm and the tips of the sheets are cut off. An Accountant produced audited accounts to show that the profits at Nsukka are credited to the firm. He says they were compiled from the Company's book, but the books are not produced. The company apparently has at present a bank account, but no accounts for the gain in question are produced. It is admitted that appellant is in charge at Nsukka. That he operates in the name of C.M. Obioha, and that he is in fact paid by UAC. It is easy enough to say that the profits received by appellant were received on behalf of a firm and paid over to the firm, but in fact there is not an atom of evidence to corroborate what he says. It ought to be easy enough, if the firm is genuine, to produce bank accounts or even the firm's book of accounts, but nothing at all is produced. Clearly the appellant has not discharged the onus of proof. Out of 2,854 pounds, the odd 854 pounds was allowed for expenses and there is nothing to show that this was unreasonable.

The appeal is therefore dismissed.

Costs of 10 pounds 10 shillings to respondent.

SUPREME COURT OF NIGERIA (ADEMOLA, C.J.)

OCTOBER 31, 1960

(On appeal to the Supreme Court of Nigeria, Ademola C.J. stated as follows):

Upon reading the record of appeal herein, and after hearing Mr. Obi Okoye of Counsel for the appellant and without calling on Mr. B.O. Okadigbo (Crown Counsel) of counsel for the respondent.

IT IS ORDERED that this appeal be dismissed with costs to the respondent assessed at 15 guineas.

A .... APPELLANT

V

COMMISSIONER OF INTERNAL REVENUE .... RESPONDENT

HIGH COURT OF EASTERN NIGERIA (HUGHES, J.)

JULY 13, 1957

Personal Income Tax — Validity of Assessment — Whether Failure to Call for Return of Income from Taxpayer was a breach of Finance Law, 1956

The appellant was assessed on an income of 1,500 pounds, but since the Commissioner of Internal Revenue did not issue notice requesting for return of income (referred to in Section 31 of the Finance Law of Eastern Nigeria, 1956) the appellant did not furnish the assessing authority with the statement of his income.

The appellant contended that the failure to issue notice calling for return of income under Section 31 of the Law was a breach of the Finance Law and that the assessment should be cancelled under rule 18(2) of the Finance Law (Appeal) Rules 1956.

HELD:

1. Section 31 of the Finance Law of Eastern Nigeria, 1956 did not impose any duty on the Commissioner of Internal Revenue to issue a notice of return of Income to the taxpayer. The commissioner had discretion in the matter; and
2. Although it was in the interest of the Commissioner of Internal Revenue and the taxpayer to call for return of income, failure to do so on the part of the Commissioner was not an infringement of any provision of the law, and an assessment could not be cancelled simply by reason of such failure.

CASE REFERRED TO:

1. Sam Anyogu V. Commissioner of Internal Revenue (Appeal No. E/62/195)

LEGISLATION CONSIDERED:

1. Finance Law of Eastern Nigeria, 1956 Sections 19 and 31
2. Income Tax Regulations, 1956 Regulation 3

JUDGMENT

(By Hughes, J.)

This is an appeal under Section 19 of the Finance Law, 1956 (No. 1 of 1956) herein referred to as "the law".

The evidence of the appellant is that he received an Income Tax Assessment Notice calling on him to pay tax in the sum of 283 pounds 10 shillings on an income assessed at 1,500 pounds. He did not at any time receive the notice referred to in Section 31 of the Law, and, it is submitted by the appellant, failure on the part of the Commissioner (which expression is used herein to include a

Local Government Council person or group of persons appointed by the Commissioner) to send such a notice, is a breach of the requirement of the Law and therefore what purports to be an assessment should be cancelled under rule 18(2) of the Finance Law (Appeal) Rules, 1956.

The first matter for consideration is whether Section 31 of the Law does in fact require the Commissioner to send to a person who is liable to pay tax, the notice referred to in that Section.

There is no difficulty in interpreting Section 31 of the Law as it is without ambiguity; the material part of the Section, for purposes of the submission of the appellant, reads:

"31 (i) Every person liable to pay tax for any year of assessment, when required to do so by notice in writing by the Commissioner or any person appointed by him in that behalf shall, within the period limited by such notice, prepare and deliver to the Commissioner or to such person a true and correct statement in writing containing..."

It is clear that the Section imposes no duty whatever on the Commissioner to send the notice; he has a discretion in the matter and if he elects to send the notice then the duty is on the person to whom it is sent to furnish the particulars called for. If support were needed for the view that the sending of the notice referred to in Section 31 of the Law is a matter of discretion, it is to be found in Regulation 3 of the Income Tax Regulations, 1956, to which the appellant has referred; that regulation reads in part:

"3. In order to facilitate the estimation and computation of income and the assessment of tax a local Government Council may serve on any person... a Householder's Form, a Return of Income Form and a Marriage Particulars Form."

The appellant has referred to the case of Sam Anyogu v. The Commissioner of Internal Revenue (Appeal No. E/62A/1956) in which judgment was given on the 25th of March, 1957. The relevant facts of that case are that the Tax Assessment Authority proceeded to make an assessment before receipt of the return of income demanded by the Authority and before expiry of the time for making the return. In that case, the assessment was cancelled and a reassessment ordered. I quote the following passage from that judgment:

"In their deliberations, they (the Tax Authority) cannot ignore the declaration of the taxpayer if they have asked for it. They may consider that declaration to be false or ludicrous, but they must consider it, and in the great majority of cases they should not brush it aside without enquiry from the person making the declaration. It is my opinion, and I should welcome the opinion of a higher authority however adverse, that this Court cannot sustain an assessment made without waiting for the taxpayer's return if such a return has been called for and the time of making the return has not expired."

It is clear that the overriding consideration was the fact that the Authority had called for a return and thereby indicated that it was considered necessary for the purposes of making an assessment to have particulars from the taxpayer concerned. In the instant case no return was called for and therefore the decision in Sam Anyogu v. The Commissioner of Internal Revenue (supra) cannot be regarded as affording guidance in this case.

The Commissioner, in not sending to the appellant in this case the notice referred to in Section 31 of the Law has not only deprived the appellant of the opportunity of furnishing information, on which, if accepted, the assessment would have been based, but the Commissioner has also denied himself information which, whether accepted or not, might have been of assistance in arriving at an assessment. Absence of such information has probably caused the Commissioner to make what, in this case, must have been little more than rough approximation of the income of the appellant for having regard to the fact that the income of the appellant is derived from the practice of the law, it cannot be that details of the appellant's earnings are within the knowledge of the Commissioner.

Where, as in this case, the income of the taxpayer is peculiarly within the knowledge of the taxpayer, and the Commissioner does not call for information from the taxpayer, it is most probable that the Court will, on appeal, have to consider the information which should in the first place have been made available to the Commissioner; much the same thing as this has been said by the learned Chief Justice in the case of Sam Anyogu v. The Commissioner of Internal Revenue (supra).

The position in this case, as I see it, is that though the Commissioner should in his own interest as well as that of the taxpayer, have called for a return from the taxpayer, he has nevertheless not infringed or failed to comply with any requirement of the Law or of the Rules or Regulations made thereunder and therefore this assessment cannot be cancelled by reason of the fact that the taxpayer was not called upon to make a return of income.

The other ground of appeal does not arise for consideration as the appellant has said that the particulars stated with reference thereto in the grounds of appeal relate to a year other than the one to which the assessment refers.

There is no evidence before the Court that the assessment is excessive and accordingly the appeal must be dismissed.

Appeal dismissed.

MARK CHIGBO .... APPELLANT

V

COMMISSIONER OF BOARD OF INTERNAL REVENUE .... RESPONDENT

HIGH COURT OF EASTERN NIGERIA, ENUGU (REYNOLDS, J.)

NOVEMBER 11, 1957

Personal Income Tax — Assessment on Best of Judgment in Absence of Information — Onus of Proof of Excessive Assessment

The appellant derived his income from 3 lorries used for commercial purposes and from petty produce trade. He however failed to give correct information to the tax authority on his income from these sources.

The respondent assessed the appellant on its best of judgment for 1955/56 assessment year after the failure of the appellant to give the record of accounts of his income. The appellant appealed against the assessment contending that the assessment was excessive.

HELD:

As the appellant did not give sufficient evidence of his income, the onus of proving excessive assessment had not been discharged.

LEGISLATION CONSIDERED:

Finance Law of Eastern Nigeria,

1956 (No. 1 of 1956)

JUDGMENT:

(By Reynolds, J)

This is an appeal under Section 19 of the Finance Law 1956 (No. 1 of 1956). The appellant gave evidence that he derived his income from working 3 lorries Nos. ON 1306, E 1733 and E 2301 and from petty produce trade in the year 1955 — 56.

He said that lorry No. ON 1306 broke down in March 1955 and was sold on 27 June, 1955 for 70 pounds and between these dates earned no income. With regard to lorry E 1733 he said it was used for transporting palm kernels from Nuskka-Onitsha on an average of twice a week at 11 pounds 2 shillings 3 pence per trip. The lorry took passengers on the return trip averaging about 10 shillings per trip. During the year 1955/56 this lorry made 45 trips earning 522 pounds 11 shillings 3 pence. Appellant stated that lorry E 2301 was bought on 23/2/56 and began running in March up to 31 March 1956 and it made about 8 trips from Nsukka to Onitsha carrying palm kernels and earned 88 pounds 18 shillings. Appellant agreed that on his produce trade the assessment of 10 pounds made was incorrect. He said therefore that his assessable income for the year 1955/56 was 621 pounds 9 shillings 3 pence.

The respondent called Mr. Akpanweze, Secretary to the Eze District Council which is the taxing authority in the appellant's area. He said that he had sent out an income tax return form to appellant in respect of his income for 1955/56 and that his had been completed and returned (Ex. A). In the particulars of his total earnings from all sources for the year ended 31/3/56 opposite paragraph (b) Profits from all trades, businesses, profession and vocations he wrote "Accidents took profits, hardly got 36 pounds" and he returned his total earnings as 46 pounds.

The Committee (that is the taxing authority) was not satisfied with this return and appellant was invited for an interview and questioned about his earnings from his lorries. With regard to lorry ON 1306 the appellant had stated that the lorry had run up to 27/6/56 and then sold. He did not say that the lorry had not been working. In respect of lorry E 1733 appellant has said that it had not been working for 1 month during the period in question. He did not tell the Committee that it made only 2 trips weekly to Onitsha. He would not tell the Committee anything except that he was running the lorry at a loss. With regard to lorry E2301, he did not tell the Committee how many trips it made to Onitsha weekly. As the appellant would not give the information upon which it could assess the earnings of the lorries, the Committee had to use the arbitrary method set out in the instructions from the Ministry of Finance.

The earnings of ON1306 were calculated on the basis of working 77 days running 80 miles daily and earning 4 pence per mile namely 100 pounds.

The earnings of E1733 were computed on 312 working days running 160 miles per day and earning 10 pence per mile — 2,083 pounds. From this was deducted 1,020 pounds and 160 pounds for major repairs leaving a balance of 903 pounds.

The earnings of lorry E2301 as for 32 working days travelling 160 miles daily and earning 10 pence per mile, namely 213 pounds; from this was deducted a proportionate part of the cost of the lorry, 108 pounds leaving a balance of 105 pounds.

This witness said that the passenger fare from Nsukka to Onitsha in January 1956 was 4 shillings and is still the same today. The appellant had been asked by the Committee to give a written statement of his earnings but has refused to do so.

After careful consideration of the demeanour of the appellant and his evidence, I have come to the conclusion that he is not a truthful or reliable witness. On the other hand, I consider the witness for the respondent to be accurate and truthful.

Even if the evidence of the appellant were accepted at its face value it would not be possible, in my opinion, to make a proper assessment on it. In my opinion, due to the evasions and prevarications of the appellant, the Committee was left with no option than to assess the appellant in the way they

did, and in the circumstances I consider the assessment to be a proper one. As I am unable to accept the evidence of the appellant it follows that he has not discharged the onus upon him of showing that the assessment was excessive and the appeal is therefore dismissed and the assessment is confirmed.

JOHN IHEKWOABA .... APPELLANT

V

THE COMMISSIONER OF INTERNAL REVENUE .... RESPONDENT

SUPREME COURT OF NIGERIA, LAGOS (DE LESTANG, AG. F.C.J, COUSSEY, AG.

F. J; HEDGES AG. F. J.) MARCH 31, 1958

Personal Income Tax — Assessment on turnover in absence of information — Onus of proof of Excessive Assessment

The appellant was a member of the Eastern House of Assembly of Nigeria and his income in this regard was small and ascertainable. He also had other business income as a produce dealer on which there was no information. The appellant was assessed to tax on the estimate of the turnover of the business.

The appellant appealed to the High Court and then to the Supreme Court but failed to prove that the assessment was excessive.

HELD:

The onus of proving that an assessment was excessive is on the taxpayer, and the appellant has failed to discharge the onus.

LEGISLATION CONSIDERED:

Finance Law of The Eastern Region, 1956 Sections 17 and 18

JUDGMENT:

(By Hedges, Ag. F.J.)

This is an appeal against the decision of the High Court of the Eastern Region dated 24th April, 1957.

The appeal, which presents no difficulty, is on an income tax matter. The appellant's income had been assessed by the appropriate authority at Port Harcourt and being dissatisfied he appealed to the High Court. Whilst the appeal was pending, the Commissioner, somewhat prematurely, reduced the amount of the assessment, but naturally the appellant does not complain about that.

The appellant did very little to assist the taxing authority. During the relevant period, apart from his income as a member of the Eastern House of Assembly which was comparatively small, he had a substantial turnover of business as a produce dealer. In the absence of detailed information the

Commissioner made an assessment which clearly bore some direct relation to the turnover of business. This he was entitled to do, and indeed he could not do otherwise.

If Section 18 of the Finance Law (No. 1 of 1956) of the Eastern Region be read in conjunction with subsection (3) of Section 17 of the same Law, it is clear that the onus of proving that an assessment is excessive is on the appellant.

The only ground of appeal argued seriously (or indeed at all) before this Court concerned a particular passage in the judgment of the learned Judge in the Court below. I do not quote the passage because, although I think it was most unfortunately phrased, this ground of appeal is, in my opinion, without substance. It is clear from the record that the appellant, upon whom the onus of proving the assessment excessive lies, failed completely to discharge the onus, except as regards assessment in relation to a house at Diobu with which the present appeal is not concerned.

In the result I think this appeal is without merit and I would dismiss it with costs assessed at 35 pounds.

ABOUD .... APPELLANT

V

REGIONAL TAX BOARD .... RESPONDENT

SUPREME COURT OF NIGERIA, LAGOS

(BRETT, COKER, IDIGBE, JJ, S.C.)

FEBRUARY 11, 1966

Personal Income Tax — Artificial or Fictitious Transaction — Effect of Failure to Appeal against Assessment within Time Limit — Whether Court could declare assessment null and void after the assessment had become final and conclusive

The appellant was assessed to pay income tax in respect of certain property. The property in question was transferred by the appellant to his wife, and he brought an action seeking a declaration that he was not liable to pay income tax in respect of the property and that the assessment was null and void.

The respondent treated the transfer as an artificial or fictitious transaction under Section 15 of the Income Tax Law (cap. 48) of Western Nigeria, and assessed the appellant to tax on an income which included rent from the property. The High Court of Western Nigeria which heard the case considered the claim on its merit and dismissed the action without considering whether it could properly entertain the declaration sought by the appellant.

The Supreme Court of Nigeria raised the matter in its own motion as a preliminary issue having regard to Section 55 of the Income Tax Law (cap. 48) which provided for a time limit for Accounting Periodappeals against assessment, the appellant not having exercised his statutory right of appeal.

The appellant contended that even if he could no longer maintain an appeal against the assessment, the court could give a declaratory judgment and an authoritative interpretation of Section 15 of the Income Tax Law of Western Nigeria (cap. 48).

HELD

1. Where no appeal had been lodged against an assessment within the statutory time permitted by the law, the assessment should be final and conclusive for all purposes of the Law as regards the amount of the chargeable income.

2. The court would not give a declaratory judgment where no useful purpose would be served.

LEGISLATION CONSIDERED

Income Tax Law (Laws of Western Nigeria) (cap. 48) Sections 15, 38 and 55

THE FEDERAL BOARD OF INLAND REVENUE .... PLAINTIFF

V

AZIGBO BROTHERS LIMITED .... DEFENDANT

HIGH COURT OF NORTHERN NIGERIA (SMITH, S.P.J.)

NOVEMBER 8, 1962

Companies Income Tax — Assessment in Default of Return of Income — Refusal to Object or Appeal against Assessment — Whether Assessment was made to the Best of Judgment of the Tax Authority — Whether Assessment on Best of Judgment could exclude Capital Allowances

The Plaintiff was claiming from the defendant the arrears of income tax for 1960/61 and 1961/62 years of assessment. The assessments were based on the best of judgment of Plaintiff after the failure of the defendant to submit the return of income and the accounts as demanded by the plaintiff. No Accounting Periodcapital allowances were granted to the defendant on the assessments. Also the defendant neither objected to nor appealed against the assessments until they became final and conclusive.

The defendant contended that the assessments were arbitrary and were not made to the best of judgment of the plaintiff having regard to the fact that no capital allowances were granted to it on the capital expenditure incurred and carried forward in the previous years' accounts.

The plaintiff contended that the capital allowances were not granted to the defendant because they were not claimed in writing as required by the law.

HELD

1. The assessments were made to the best of judgment of the plaintiff as there was no information on the actual earnings of the defendant at the time of making the assessments.

2. Assessment based on best of judgment could exclude capital allowance if the taxpayer failed to claim it in writing as required by the law, or by way of objection or appeal.

CASE REFERRED TO

Chairman of the Board of Inland Revenue V Joseph Rezcallah and Sons Ltd. (1962) I ALL NLR 1, (1961) NR NLR 32

LEGISLATION CONSIDERED

1. Companies Income Tax Act, 1961, Sections 49(3) and 53(1)

2. Income Tax Ordinance, 1958 (Cap. 85) Sections 55(3), 59(2) and 67(1)

S. E. OLA .... APPELLANT

V

FEDERAL BOARD OF INLAND REVENUE .... RESPONDENT

FEDERAL REVENUE COURT, LAGOS

(OMO-EBOH, J.)

MARCH 1, 1974

Personal Income Tax — Failure of Taxpayer to disclose all sources of income — Whether assessments which had become final and conclusive could be reopened — Whether assessment notices which did not give particulars of the assessments were valid in law — Whether Appeal Commissioners erred in Confirming an assessment which did not give any Capital Allowances — Whether Judgment written one year after summary dismissal of the case was regular.

The appellant was an employee and an agent of United Africa Company (Nig.) Limited (UAC) and he was paid both salary and commission for his services. Income rates were deducted on the salary and commission annually under the Pay As You Earn Scheme.

The respondent discovered at a point in time that the appellant owned two houses in Lagos and some lorries used in transport business, both of which fetched additional income which were not disclosed by the appellant to the respondent. Consequent upon the discovery, the appellant was invited for an interview by the respondent and he was advised to submit audited accounts on his various sources of income to cover the period 1962 to 1968.

The appellant submitted the accounts for 1966/67 and 1967/68 years of assessment only, and claimed Accounting Periodcapital allowances for the two years. Assessment notices were raised by the respondent on the basis of these accounts and the appellant paid the taxes accordingly.

Subsequently the accounts were rejected by the respondent, and six additional best of judgment assessments were raised against the appellant to cover the period 1962 to 1968 which amounted to 5,854 pounds. No capital allowances were granted to the appellant on the new assessments, and five of the six assessments did not give the particulars on which the assessments were based.

The appellant appealed against the Accounting Periodadditional assessments before the Body of Appeal Commissioners and the Appeal Commissioners summarily dismissed the appeal and confirmed the assessments although the judgment was written after one year of the dismissal, and two of the Commissioners who heard the case did not sign the judgment.

At the hearing of the appeal before this court, the appellant contended that the additional assessments were improper and should be discharged for the following reasons:

1. That an assessment once made by the tax authority and not objected to or appealed against by the taxpayer should become final and conclusive under the law and that such assessment could not be reopened on the same facts. That the respondent was therefore wrong in law in making the additional assessments, having first assessed the appellant on the accounts submitted;

2. That five of the six assessments were bad in law as they did not contain, in substance and effect, the particulars on which the assessments were made in accordance with Section 35 of the Personal Income Tax (Lagos) Act, 1961; and

3. That the Body of Appeal Commissioners erred in confirming the assessments when no capital allowances were granted in any of the six assessments as provided for by Section 20 of the Personal Income Tax (Lagos) Act, 1961 and as duly claimed by the appellant in the accounts submitted.

The respondent replied to the submissions as follows:

1. That the appellant never submitted any account in respect of earlier years apart from the declaration of his Salaries and Commission, and that it was after the respondent discovered that the appellant had other sources of income that the respondent raised additional assessments;

2. That the appellant had committed fraud or wilful default by not rendering correct or full return of his income, and that when the statements of accounts were prepared by the appellant, they were found to be untrue and unhelpful and for these reasons the accounts were rejected by the respondent;

3. That the additional assessments were necessitated by new discoveries of appellant's sources of income hitherto undisclosed by him and that such additional assessments were allowed under Section 31(1) of the Personal Income Tax (Lagos) Act, 1961;

4. That the appellant had no sufficient evidence before the Appeal Commissioners to enable them grant him capital allowances; and

5. That it was not the usual practice of the respondent to give the particulars on which the assessments were based.

HELD

1. The Accounting Periodadditional assessments were necessitated by the discovery of sources of income which were never previously disclosed by the appellant and were based upon new facts which he never denied, and the respondent had power to raise such assessments under Section 31(1) of the Personal Income Tax (Lagos) Act, 1961. It was therefore not correct to say that the additional assessments were based on the same facts as those on which the previous assessments were made;

2. The provision of the law with respect to the particulars on which the assessments were based, was mandatory under Section 35 of Personal Income Tax (Lagos) Act, 1961 and such 'particulars' should be stated in the notice of assessment. The particulars were not only necessary but essential to enable an assessee to know the sources and/or the basis for the assessment of his chargeable income and to enable him see that he was not charged to tax twice on the same income for the same period. Such provision of law could not be varied or modified by the usual practice of the respondent;

3. Having regard to the discoveries made by the respondent, while one could hold that the previous assessments based on salary and commission were under-assessments, the later assessments were patent over-assessments bordering upon the unreasonable and oppressive type. The respondent or its agents had no right or power under the law to inflict any assessment which was punitive or oppressive;

4. The appellant as the owner of transport business was entitled in law to Accounting Periodcapital allowances as provided under Section 17 of the Income Tax Management Act,

1961. The Body of Appeal Commissioners was therefore wrong in not considering the issue of capital allowances claimed by the appellant as contained in the statement of accounts before it;

5. The essence of justice demanded that the Body of Appeal Commissioners, as quasijudicial body, should not rush itself or allow itself to be rushed when dealing with matters that came before it. It was equally important that the Body should not deal summarily by way of dismissal with matters that came before it except in such ones in which there were no merits whatsoever or which contained nothing to recommend them for careful consideration; and

6. Considering the facts and circumstances of the case, the additional assessments were arbitrary, excessive and vindictive and they were accordingly discharged.

FEDERAL BOARD OF INLAND REVENUE .... APPELLANT

V

THE NIGERIAN GENERAL INSURANCE COMPANY LIMITED .... RESPONDENT

SUPREME COURT OF NIGERIA, LAGOS

(COKER, UDOMA, FATAYI-WILLIAMS, JJ.S.C.)

DECEMBER 19, 1969

Companies Income Tax — Validity of Assessment — Basis for regarding assessment as final and conclusive — Whether the court could reopen Quantum of Assessment after the Assessments had Become Final and Conclusive

The appellant was claiming from the respondent a sum of 3,740 pounds being the arrears of income tax and Accounting Periodpenalties for 1963/64 and 1964/65 assessment years. The appellant duly served notices on the respondent requesting for the declaration of its income for the two years in question. The respondent did not reply. Assessment notices and penalties were then raised and sent to the respondent in respect of the two years. The respondent neither objected nor appealed against the assessments until the commencement of the action at the High Court.

The respondent contended before the High Court that the notices of return of income and assessments should have been sent to its tax consultant whose address was known to the appellant. It was further contended that some of the sources of income relied upon by the appellant to tax it were non-existent for the years of assessment concerned. The appellant on its own part contended that in the circumstance of the case, the assessments were final and conclusive as to the merit and quantum in so far as the respondent neither objected nor appealed against the assessments within the time limit permitted by the law. The trial judge held that the court could reopen the quantum of the assessments and ordered fresh assessments to be made on the respondent.

On appeal to the Supreme Court, the appellant further contended that the notices were properly and duly served on the respondent and that in the circumstances, the court could not have considered itself competent to reopen the issue of quantum of the assessments.

HELD

1. Where the assessment notices were properly served and not appealed against within the time permitted by the Act, the assessments as computed would become final and conclusive.

At that stage the court should no longer reopen the issue of quantum of the assessment; and

2. Judgment of the lower court was therefore set aside. The case was sent back to the court for fresh hearing.

WESTERN SOUDAN EXPORTERS .... APPELLANT

V

FEDERAL BOARD OF INLAND REVENUE .... RESPONDENT

HIGH COURT OF LAGOS STATE, LAGOS

(J.I.C. TAYLOR, C.J.)

JANUARY 8 1973

Companies Income Tax — Bad Debts Written Off — Whether Advance Deposits which the Taxpayer knew could not be recovered were allowable as deductible expenses — Finality of Assessment — Whether it was Necessary to Discover New Facts before Assessments which had become Final and Conclusive could be Reopened.

The appellant was a trader in groundnuts, hides and skin, who often made advance deposits to middlemen to purchase these products. At the end of each year, some of the money advanced would prove irrecoverable and the appellant would make fresh deposits to the middlemen. The appellant was of the opinion that the deposits which proved irrecoverable should be written off against the profits as bad debts. The appellant prepared its accounts for some years on this basis, and wrote off the unrecovered portion of the deposits against the profits. The accounts were earlier agreed to by the respondent.

At a later date however, the respondent reopened the issue and disallowed the bad debts written off. The respondent also raised assessments and Accounting Periodadditional assessment based on the amount disallowed. The respondent contended as follows:

(1) That the appellant could not continue to write off the unrecovered deposits or treat them as bad debts without positive action to enforce recovery as stipulated by Section 27 of the Companies Income Tax Act, 1961;

(2) That the deposits were not incurred wholly, exclusively and necessarily in the production of the profits of the appellant; and

(3) That the deposits were in fact capital expenditure, and could not be written off as bad debts; and

(4) That an assessment once agreed, should be final and conclusive against the taxpayer but not against the tax authority.

The appellant contended as follows:

(1) That the deposits were made by way of trade custom and that they were wholly, exclusively and necessarily incurred to produce the profits;

(2) That it had made efforts to recover and indeed recovered some of the debts, and that the unrecovered portions were bad debts that should be allowed under Section 27 of the Act; and

(3) That an assessment once agreed could not be reopened or revised unless there was evidence of discovery of new facts to justify the revision.

HELD

(1) The advancement of money to middlemen in the business of groundnuts, hides and skin was a custom of the trade. It acted as incentive to bring in more produce and although it might have its abuses in the hands of unscrupulous middlemen, it was an accepted usage of the trade. The money was wholly, exclusively and necessarily incurred in the production of the profits;

(2) The word 'discover' simply means 'find out,' and what had to be found out was whether any profit chargeable to tax had been omitted from the first assessment;

(3) The advance deposits were not capital expenditure but revenue expenditure and they were allowable under Section 27 of the Act; and

(4) The finality and conclusiveness of an assessment should not work against the taxpayer alone as Section 59 of the Act also brought the tax authority within the ambit of finality.

FEDERAL BOARD OF INLAND REVENUE .... PLAINTIFF

V

WEST AFRICAN PICTURES CO. LTD .... DEFENDANT

FEDERAL REVENUE COURT, LAGOS

(ADEDIRAN, J.)

MARCH 19, 1974

Companies Income Tax — Whether Notice of Return of Income Served on the Auditors of the Company instead of the Company itself was Validly Served — Failure to Send Accounts to the Tax Office — Failure to Object to Assessment Notices.

The plaintiff was claiming from the defendant a sum of ₦12,911.17 being the arrears of income tax and Accounting Periodpenalties for five years of assessment, 1960/61, 1966/67, 1967/68, 1968/69 and 1969/70.

The assessment notices, which were based on best of judgment of the plaintiff, were raised after the failure of the defendant to send its returns of income in compliance with earlier requests made for them by the plaintiff.

The defendant, instead of filling the return of income forms, gave promise to send the forms and the accounts at a later date. The defendant failed to send the forms and the accounts except in respect of 1960/61 which was sent late.

The defendant contended that the notices requesting for returns of income were not received by it since they were addressed to its Auditors instead of the company itself and that for that reason the notices were not valid. The defendant further contended that it made no profits in the years under consideration, and therefore was not liable to tax under Section 17 of the Act.

The plaintiff on its own part contended that even though the notices were addressed to the auditors of the defendant instead of the defendant itself, the defendant acted on them and promised to send the accounts later and for that reason the notices were validly served.

HELD

1. It was idle on the part of the defendant to argue that the notices were invalid because they were not sent to its registered address since the notices were received by it and it acted on them. It would be a different matter if the notices were not received at all by the defendant; and

2. Even if the defendant made no profit for the years under consideration, the law made it clear that a company served with notice to file return of profit was bound to comply with the request. Section 17(3) of the Act further specified that the request should be complied with whether or not a company was liable to pay tax.

ARBICO LIMITED .... APPELLANT

V

FEDERAL BOARD OF INLAND REVENUE .... RESPONDENT

SUPREME COURT OF NIGERIA, LAGOS

(COKER, LEWIS AND MADARIKAN JJ. SC.)

OCTOBER 25, 1968

Companies Income Tax — Sale of Property — Isolated Transaction — Whether Isolated Transaction Constitutes Realization of Capital or a Trading Activity — Meaning of the word, 'Trade' in Companies Income Tax Act, 1961

The appellant was a building contractor and the objects of its memorandum included the power to deal in property. The appellant acquired four building plots and built residential accommodation on one of them. The building was sold to the Federal Government of Nigeria at a profit which was appropriated to the appellant's working capital. The sale was the first sale of property by the appellant.

The respondent assessed the appellant to tax on the profit made on the property contending that the profit was in respect of Accounting Periodtrade or business of the appellant. The respondent

further contended that since the appellant's memorandum of association included the power to deal in property, there was a presumption that the sale was in furtherance of its trading objectives.

The appellant contended that the transaction was not a trade but a realization of capital and that the sale, being an isolated transaction was not trading within the meaning of the Act. The appellant also contended that the word 'Trade' had been given extended definition beyond its ordinary meaning in the Companies Income Tax Act, 1961.

HELD

1. The sale was a transaction by way of trade notwithstanding that it was an isolated transaction
2. Isolated transactions could constitute trade if the intention of the company was to deal in that line of business within its memorandum of association
3. The word 'trade' could be defined extensively to include isolated transactions
4. Appeal dismissed

CASES REFERRED TO

1. A. E. Investment Trust Ltd. V Income Tax Commissioner. (1956), 2 E.A.T.C. 99
2. Davies V Shell Company of China Ltd. (1950) 32, T.C. 133, on appeal (1951) 32 T.C. 145
3. Edward (Inspector of Taxes) V Bairstow (1956) A.C. 14; (155) 3 All E.R. 48

SHELL-BP PETROLEUM DEVELOPMENT COMPANY .... APPELLANT

V

FEDERAL BOARD OF INLAND REVENUE .... RESPONDENT

FEDERAL REVENUE COURT, LAGOS (BELGORE, J)

NOVEMBER 5, 1976

Petroleum Profit Tax — Meaning of "Petroleum Operations" — Whether Expenses Connected with Sale of Petroleum included in the Meaning of Petroleum Operations — Effect of Punctuation in Statutes

The appellant, an Oil Company incorporated in Nigeria, was carrying on the business of mineral oil extraction, and delivery for sale to overseas customers or to PortHarcourt oil refinery in Nigeria.

The appellant incurred expenses in the nature of deadfreight and demurrage which were accepted as normal business expenses in the business of selling Accounting Periodchargeable oil.

In assessing the appellant to tax, the respondent was of the view that the expenses incurred on deadfreight and demurrage were not deductible from the chargeable income in arriving at the Accounting Periodadjusted profits of the appellant. The respondent contended that sale of petroleum and the expenses connected therewith were not included in the definition of Accounting

Periodpetroleum operations under Section 2 of the Petroleum Profit Tax Act, 1959, by which the expenses would have been deductible under Section 10 of the Act.

The appellant contended that on proper construction, sale of petroleum should be included in the meaning of petroleum operation.

HELD

The only operation excluded in "Petroleum Operation" under Section 2 of the Petroleum Profit Tax Act, 1959 was refining at the refinery. Consequently, sale of petroleum was included in the definition. The expenses connected therewith were therefore deductible in the computation of the profit of the appellant.

Whether appellant bound by affidavit in other proceedings

In 1975, a taxpayer received more than £900,000 from abroad, but did not declare this in his returns. In 1976 a Hong Kong company began legal action against him, and in interlocutory proceedings in the action he swore an affidavit that the amounts were his share of profits from speculative trading in commodities. The Revenue became aware of the affidavit and raised estimated assessments under Schedule D, Case I. The taxpayer appealed, and contended that the affidavit was inadmissible as evidence until the action against him had been decided, since it contradicted an affidavit by the company which was suing him. The Commissioners rejected this contention and determined the Accounting Periodappeals. The Ch D upheld their decision, rejecting the taxpayer's contention that the case should be remitted to consider further matters not raised at the original hearing. The Commissioners determination of the appeals had been in accordance with TMA, s 50(6). Wicker v Fraser, Ch D 1982, 55 TC 641; [1982] STC 505

SHELL PETROLEUM DEVELOPMENT COMPANY *

V.

FEDERAL BOARD OF INLAND REVENUE

(SUPREME COURT)

APPEAL NO: S.C. 78/1994

M.L. UWAIS, C.J.N.,

S.M.A. BELGORE, J.S.C.,

M.E. OGUNDARE J.S.C.,

E.O. OGBUWEU, J.S.C.,

U. MOHAMMED, J.S.C.

ABSTRACT

- The definition of "Accounting Periodpetroleum operations" and the meaning of the phrase "wholly and exclusively" under the Accounting PeriodPetroleum Profits Tax Act, 1959, as amended, how construed.

- Deductible expenses under Section 10(1) of the Petroleum Profits Tax Act – whether expenses meet the requirements of being "wholly, exclusively and necessarily incurred for the petroleum operations" (the W.E.N. test).
- A consideration of the legal effects of extra statutory agreements between the Federal Government of Nigeria and companies engaged in petroleum operations varying the mode of payment of petroleum profits tax under the Petroleum Profits Tax Act, 1959, as amended, whether illegal or contrary to public policy.
- Application of the principle of accord and satisfaction to the Law of Taxation

FACTS

The Appellant was a company registered in Nigeria to engage in the business of petroleum operations. The company was therefore liable to pay petroleum profits tax pursuant to Section 8 of the Petroleum Profits Tax Act, 1959, as amended.

** As reported in Yerokun O. et al, 1997: 1. N. R. L. R. Part 1, Nigerian Revenue Projects Pubications*

The Act contained provisions on how to ascertain the chargeable petroleum profits tax payable during an Accounting Periodaccounting period and the mode of payment. Notwithstanding, the Federal Government of Nigeria imposed additional contractual and statutory obligations on the Appellant, some of which were at variance with the provisions of the Act.

The Appellant submitted its petroleum profits tax returns for the accounting period of 1 January 1973 to 31 December 1973 to the Respondent. The returns contained the revised tax assessment which in the view of the Appellant was payable by it. The Respondent disallowed the following items from the returns, which were incurred by the Appellant, on the ground that such expenses were not deductible for the purpose of computing Accounting Periodchargeable tax under the provisions of the Act:

1.	Exchange losses on payment of	
	Petroleum Profits tax	₦3,335,091
2.	Central Bank Commission for payment	
	of Petroleum profits tax	₦2,915,429
3.	Scholarship expenses	₦ 257,550
4.	Gift and donations	₦ 61,222

The Appellant objected to the exclusion of these items in the computation made by the Respondents for the tax payable on its Accounting Periodadjusted profits to the Federal Board of Appeal Commissioners. At the hearing, the appeal in respect of the 4 item on "Gift and donations" was abandoned by the Appellant. In its ruling the Federal Board of Appeal Commissioners dismissed the Appellant's appeal and confirmed the revised assessment made by the Respondent.

The Appellant appealed further to the Accounting PeriodFederal High Court against the ruling of the Federal Board of Appeal Commissioners. The Federal High Court allowed the appeal in respect of exchange losses and Central Bank of Nigeria charges, but dismissed the appeal against the scholarship expenses.

Both the Appellant and Respondent were dissatisfied with the decision of the Federal High Court and appealed to the Court of Appeal. The Appellant, against the confirmation of the assessment on scholarship expenses and the Respondent against the annulment of the assessment on exchange losses and Central Bank of Nigeria charges.

In its judgement the Court of Appeal dismissed the appeal by the Appellant and allowed the appeal by the Respondent and thus set aside the decision of the High Court in respect of exchange losses and Central Bank of Nigeria charges.

The Appellant finally appealed to the Supreme Court.

ARGUMENT

The facts of the argument on the 3 items will be separated and treated in seriatim.

EXCHANGE LOSSES

It was common ground between the parties that the tax payable by the Appellant was assessable in Naira under the provisions of the Accounting PeriodPetroleum Profits Tax Act, 1959 as amended. Notwithstanding the provisions of the Act, there were a number of formal agreements entered into by the Federal Government of Nigeria and the Appellant which altered the manner and the place where the tax assessed was to be paid. For instance, on the 15 March, 1968 the Exchange Controller of the Federal Ministry of Finance wrote a letter (Exhibit 4) to companies engaged in Accounting Periodpetroleum operations, (including the Appellant) directing them to pay, with effect from 1 January, 1968, all payments due to the Federal Government of Nigeria in respect of Accounting Periodroyalties, petroleum profits tax and rents to the account of the Central Bank of Nigeria with the Bank of England. As the amounts due were normally expressed in Nigerian pound (now Naira), the Appellant was further directed to ensure that enough Sterling were made available to make Nigerian pound equivalent of the amount due from the Appellant.

The above directive resulted in the Appellant converting the United States dollars into Naira and then converting Naira into Pound Sterling in order to be able to meet its obligation to the Federal Government of Nigeria. The conversion from United States dollars to Naira became necessary because the former was and still is the currency in which the sale of petroleum is made. It was because of the conversions which the Appellant had to undertake that it claimed that it incurred losses. Hence its demand that the losses should be deductible for tax purposes.

The questions which arose before the Federal Board of Appeal Commissioners were whether or not:

(i) The determination of the deductions due to the Appellant should be limited to the Petroleum Profits Tax Act, 1959 or whether it should be extended to the formal agreements and the letter (Exhibit 4).

(ii) Whether the exchange losses were expenses "wholly, exclusively and necessarily" incurred for the petroleum operations of the Appellant which according to Section 10(1) of the Petroleum Profits Tax Act, 1959 should be deducted from the aggregate profits to arrive at its Accounting Periodadjusted profits for the 1973 Accounting Periodaccounting period.

The Federal Board of Appeal Commissioners held in its ruling that the issues dealt exclusively with the interpretation of Sections 2, 8, 9, 10 and 11 of the Accounting PeriodPetroleum Profits Tax Act, 1959 and that the agreements together with Exhibit 4 could not apply to vary the provisions of the Act. The Board of Appeal Commissioners reasoned that the agreements were not part of the Petroleum Profits Tax Act, 1959 and since the agreements were not properly enacted into law they cannot override the law and that any of its provisions which is in conflict with the law will be ultra vires.

Being dissatisfied, the Appellant appealed to the Accounting PeriodFederal High Court against the decision of the Federal Board of Appeal Commissioners. It was a common ground between the parties that the tax payable was assessable in Naira and that by the provision of the Petroleum Profits Tax Act, such tax if not paid constituted a debt owed by the Appellant which was payable to the Respondent. The Appellant argued that the agreement was meant to abrogate the provisions of the Petroleum Profits Tax Act, whereby petroleum profits tax was to be paid to the Respondent in Naira in Nigeria and to substitute by way of accord and satisfaction, an agreement whereby the Appellants were obliged to pay their profits tax obligation in Pounds Sterling into the account of The Central Bank of Nigeria with the Bank of England.

The Federal High Court accepted the Appellant's argument and held that the Appellant's obligations to pay its Petroleum Profits Tax in Naira in Nigeria had been dissolved and discharged.

Regarding the issue whether the amounts paid were expenses "wholly, exclusively and necessarily" incurred for the Appellant's Accounting Periodpetroleum operations, the Appellant argued that if it (like other oil companies) had not been required by the agreements to pay in Sterling instead of Naira it would not have incurred any losses. The Federal High Court accepted the Appellant's argument and upheld that the expenses were incurred wholly, exclusively and necessarily for the purpose of petroleum operations of the Appellant.

The Respondent being dissatisfied with the decision, appealed against it to the Court of Appeal.

The Court of Appeal construed the meaning of "petroleum operations" as defined in Section 2 and also the scope of Sections 10 and 11(1)(f) of the Petroleum Profits Tax Act and held that (i) exchange losses could not by any stretch of imagination pass "the W.E.N. test" under Section 10(1). (ii) That Section 11(1)(f) specifically disallowed the deduction of any amount incurred in respect of any income tax, profits tax or other similar tax, whether charged within Nigeria or elsewhere. (iii) That since the agreements between the Appellant and the Federal Government of Nigeria did not provide for the deduction of expenses incurred, one of the parties cannot unilaterally do so.

Accordingly, the appeal on exchange losses was allowed and the Federal High Court's decision was set aside.

The Appellant was aggrieved by the Court of Appeal's decision and appealed to the Supreme Court and argued that the definition of "petroleum operations" in Section 2 of the Petroleum Profits Tax Act, 1959 included all operations that were incidental to petroleum operations. Therefore, the Appellant submitted that all its activities which were not strictly petroleum operations but which were activities occurring or liable to occur in connection with those operations should be deemed to be "petroleum operations".

The Appellant argued further that the agreement between it and the Federal Government, was an agreement entered into by it in connection with its petroleum operations. Therefore, it contended that losses incurred by it in discharging the contractual obligations under the agreement in question were incurred for the purposes of petroleum operations. Regarding Section 11(1)(f) of the Petroleum Profits Tax Act, 1959, the Appellant admitted that the Section clearly intended to disallow deductions of amounts paid in respect of income tax, profits tax and other similar taxes. The Appellant, however, contended that the payments made by it in Pounds Sterling were based upon the amount of debt payable in Naira owed by it to the Federal Government of Nigeria pursuant to the provision of Section 41(1) of the Act. The Appellant, therefore, submitted that it was a misconception both in law and fact for the Court of Appeal to regard such payment as tax. The Appellant, therefore, urged the Supreme Court to hold that Section 11(1)(f) of the Accounting PeriodPetroleum Profits Tax Act did not prevent the deduction of exchange losses.

The Respondent, in reply, submitted that the "W.E.N. test" in Section 10(1) of the Petroleum Profits Tax Act, was applicable to the exchange losses as found by the Court of Appeal. The Respondent

argued that the exchange losses were incurred after profits had been earned and after the completion of the Accounting Periodpetroleum operations of the Appellant. Nor were they incurred in the course or as a result of or within or during the business activities of the Appellant. Hence, the Respondent submitted that exchange losses were not expenses incurred on operations that were incidental to petroleum operations of the Appellant.

Referring to the agreements between the Appellant and the Federal Government of Nigeria, the Respondent submitted that the payment of tax was a mandatory statutory and Constitutional obligation of all companies and that the agreement merely modified the procedure for making the payment of the petroleum profits tax. Hence, the Respondent urged the Supreme Court to interpret the agreement in a manner that renders them secondary to the statutory obligation of the Appellant under the Act.

The Respondent referred to the Petroleum Profits Tax (Amendment) Act, 1973 and argued that the Act incorporated the agreement between the Appellant and the Federal Government of Nigeria. It was further argued that the provisions of the 1973 Act did not provide that there should be deduction from the adjusted profits of the Appellant in respect of exchange losses and that Section 11(1)(f) of the Petroleum Profits Tax 1959 clearly disallowed the claim for deductions by the Appellant in respect of exchange losses. Finally, the Respondent submitted that the principle of accord and satisfaction was not formulated with any tax law in mind and therefore, it cannot supercede any statutory provisions governing taxation.

CENTRAL BANK OF NIGERIA CHARGES

The Permanent Secretary, Federal Ministry of Finance wrote a letter dated 15th of March, 1968 to the Appellant. The letter directed the Appellant to pay a commission of 0.5 percent with effect from 1st January, 1968 in respect of Pound Sterling lodgments into the account of the Central Bank of Nigeria with the Bank of England. The Appellant complied with this directive and sought to deduct the bank charges from its profits in arriving at its Accounting Period Accounting Period adjusted profits under Section 10 of the Petroleum Profits Tax Act, 1959. The argument in respect of Central Bank Charges was similar to the argument on exchange losses save that it called into question the status of the Central Bank of Nigeria.

The Appellant claimed that the charges were deductible under Section 10(1) or Section 10(1)(g) of the Petroleum Profits Tax Act. The Federal Board of Appeal Commissioner did not agree. Section 10(1)(g) of the Petroleum Profits Tax Act allowed the deduction of:

"all sums the liability for which was incurred by the company during that period to the Federal Government of Nigeria, or to any State or Local Government by way of any rate, impost, fee or other charges."

The question for determination in this respect was whether the Central Bank of Nigeria charges incurred by the Appellant were:

(a) Outgoings and expenses wholly, exclusively and necessarily incurred for the purpose of its petroleum operations or whether they were expenses incurred in respect of tax on its profits

or

(b) Sums the liability for which were incurred to the Federal Government by the Appellant by way of any rate, impost, fee or other like charges.

The Appellant argued that by their nature, the Central Bank of Nigeria charges were not charges made by the Bank for services rendered to it; rather it was a sum fixed by the Federal Government without any real connection with or reference to any services. Reference was made to the provisions

of Section 10(1)(g) of the Petroleum Profits Tax Act, 1959, as amended and it was submitted that the Section allowed for the deduction of the Central Bank of Nigeria charges.

In reply, the Respondent urged that the phrase "all operations incidental thereto" in Section 2 of the Petroleum Profits Tax Act, 1959 as amended which defined "Accounting Periodpetroleum operations" must not be read in isolation from the rest of the definition but that it must be read in conjunction with the various activities specified earlier in the definition in accordance with the construction rule of ejusdem generis. Therefore, applying the rule to the phrase, the Respondent submitted that the phrase would mean "things or operations incidental to drilling, mining, extracting or other like operations" as stipulated in Section 2 of the Petroleum Profits Tax Act.

Also, the Respondent submitted that the Central Bank of Nigeria charges were incurred by the Appellant in the process of paying tax on the Appellant's profits and thus fulfilling its tax obligation hence, the expenses were not deductible by virtue of Section 11(1)(f) of the Petroleum Profits Tax Act, 1959, as amended. It was argued that Section (10)(1) allowed deductions for expenses incurred from 'petroleum operations' and one cannot readily see how bank charges incurred in the process of paying tax for profits made can be said to arise from 'petroleum operations' as defined in Section 2 of the Petroleum Profits Tax Act, 1959. The Respondent, therefore, submitted that the expenditure for the Central Bank of Nigeria charges were incurred after the conclusion of petroleum operations by the Appellant.

Furthermore, the Respondent argued that the commission paid to the Central Bank of Nigeria by the Appellant was not deductible expenses under Section 10(1)(g) of the Petroleum Profits Tax Act, 1959; because the commission was not incurred to the Federal or State Government or a Local Authority but to the Central Bank of Nigeria which was not one of the three authorities mentioned in the Section.

SCHOLARSHIP EXPENSES

The Appellant in furtherance of its statutory obligations under Regulations 26 and 27 of the Petroleum (Drilling and Production) Regulations, 1969 (now Cap 350 of the Laws of the Federation, 1990) drew out a scholarship scheme which was approved by the Minister of Petroleum and in pursuance of it awarded scholarships in 1973 to the tune of ₦257,550.00. The Appellant claimed that the amount was deductible under Section 10 of the Accounting PeriodPetroleum Profits Tax Act, for the purpose of computing its Accounting Periodadjusted profits from petroleum operations. The claim was denied by the Respondent. The denial was contested before the Federal Board of Appeal Commissioners which also disallowed it. The Accounting PeriodFederal High Court as well as the Court of Appeal upheld the decision of the Federal Board of Appeal Commissioners. The Appellant finally appealed to the Supreme Court.

The scholarship scheme was made up of two categories, the first being for the generality of the Nigerian undergraduates which concerns this appeal while the second category was exclusively for its employees. The object was to employ as many as possible of the beneficiaries of the awards that obtained 1st class or 2nd class lower in their training while scholars who failed to obtain the required grade were not employed.

The main issue for determination in this regard was whether the scholarship expenses were outgoings and expenses incurred "wholly and exclusively for the purpose of the Appellant's petroleum operations".

The Appellant gave evidence and argued that the Federal Government of Nigeria will not permit it to continue to operate if it failed to award scholarship for its non-employees. In reply, the Respondent argued that the category of scholarship for the Appellant's non-employees does not satisfy the requirement of Section 10(1) of the Accounting PeriodPetroleum Profits Tax Act since it cannot be

shown to satisfy the test of being wholly, exclusively, and necessarily incurred for the Accounting Periodpetroleum operations of the Appellant.

HELD (Unanimously allowing the appeal) –

On Taxable Person

1. By Section 8 of the Petroleum Profits Tax Act, 1959, as amended, any company engaged in petroleum operations is liable to pay petroleum profits tax;

On the Definition of "Petroleum Operations"

2. The definition of the phrase "all operations incidental thereto" in Section 2 of the Petroleum Profits Tax Act cannot be circumscribed to "drilling, mining, extracting and other like operations." To do so is to do violence to the true meaning of the definition of "petroleum operations";

3. The ejusdem generis rule must not be pushed too far. It is to be applied with caution. It is wrong to treat it as if it is automatically applicable since it is a mere presumption in the absence of other indications of the intention of the Legislature. The modern tendency of the law is to attenuate the application of the rule. There must be a distinct genus or category before the rule can be invoked; and

4. A close examination of the definition of the words "petroleum operations" in Section 2 of the Act would show that the specific words therein are not limited to "drilling, mining, extracting or other like operations" but include in addition the phrase "or process, not including refining at a refinery, in the course of a business carried on by the company engaged in such operations".

On the meaning of "wholly, exclusively and necessarily"

5. According to ordinary dictionary meaning, the words "wholly" and "exclusively" have virtually the same meaning. They can be said to mean "solely" or "entirely". The dictionary meaning of the word "necessarily" is the same as that of the words "inevitably" and "unquestionably". Therefore the requirement that expenses must be incurred "wholly, exclusively and necessarily" is satisfied if the expenses are "solely" and "inevitably" incurred for petroleum operations;

6. If expenses were incurred for the purpose of paying petroleum profits tax, they would not have been deductible since such outgoings cannot be said to be incurred for the purpose of petroleum operations as defined by Section 2 of the Act. Nor can they be said to have been incurred wholly, exclusively and necessarily for the purpose of petroleum operations. They would have fallen under the head of expenditure incurred after the petroleum operations had been carried out and would not, therefore, qualify as deductible expenditure under the provisions of Section 10 of the Act;

7. The foregoing would have been the correct position in law had it been that this case was contested purely on the provisions of the Petroleum Profits Tax Act, 1959, as amended, because the principle of construction of statute is that if the words of the statute are plain, precise and unambiguous they should be given their ordinary and natural meaning; and

8. The Appellant was under additional obligations by virtue of (i) the agreement between the Appellant and the Federal Government of Nigeria (ii) the directive on payment of the Central Bank of Nigeria charges (iii) Regulations 26 and 27 of the Petroleum (Drilling and

Production) Regulations, 1969. Failure to discharge these obligations would have undoubtedly rendered the Appellant liable to sanction at the instance of and by the Federal Government of Nigeria.

On the Status of Extra Statutory Agreements

9. The agreements are not illegal contracts because their terms varied the obligations of the Appellant and the Respondent under the Accounting PeriodPetroleum Profits Tax Act, 1959, nor are they against public policy. Since the agreements are not illegal, it follows that the principles of contract can rightly apply to them. Hence, the issue of accord and satisfaction becomes pertinent to this case.

On the Application of the Principle of Accord and Satisfaction

10. By the provisions of Section 41(1) of the Petroleum Profits Tax Act, 1959, the Respondent may sue for and recover tax in a court of competent jurisdiction. Since the tax is to be deemed "as a debt due to the Government of the Federation", it follows that the obligation to pay petroleum profits tax is the same as the obligation to pay debt; and

11. Accord and satisfaction is the purchase of a reAccounting Periodlease from an obligation whether arising under contract or tort by means of any valuable consideration not being the actual performance of the obligation itself. The accord is the agreement by which the obligation is discharged. The satisfaction is the consideration which makes the agreement operative.

In Respect of Exchange Losses

12. In the present case it is incidental for the Appellant to pay debt for the purpose of its Accounting Periodpetroleum operations as defined by Section 2 of the Petroleum Profits Tax Act, 1959. However, Section 11 subsection 1(f) of the Act disallows any deductions on such debt;

13. The Appellant could not have incurred the exchange losses but for agreements between the Appellant and the Federal Government and the directive (Exhibit 4). If the payment of the tax were to have been made in local currency no such losses would have arisen; and

14. Similarly, if the Federal Government of Nigeria had been paid the tax in Naira and it was to purchase Pound Sterling equivalent to the amount so paid it would have incurred the exchange losses. Hence, there was no reason why the Respondent should not allow deductions in respect of exchange losses suffered by the Appellant.

On the Application of the Doctrine of Equity

15. By reason of the agreements and not the provisions of the Petroleum Profits Tax Act, 1959, as amended, the doctrine of equity will apply to compensate Appellant for the exchange losses incurred.

In Respect of Central Bank of Nigeria Charges

16. In computing the Accounting PeriodAccounting Periodadjusted profits of the Appellant, bank charges cannot be deducted under the provisions of Section 10(1)(g) of the Act. This is because Central Bank of Nigeria is not the Federal Government nor Government of any State or a Local Government Authority.

17. Once there is a statutory or contractual obligation, and in this case it is the former, for a company engaged in petroleum operations to perform, such obligations is "wholly",

"exclusively" and "necessarily" incurred for the purpose of the petroleum operations of the company.

18. The payment of bank charges to the Central Bank of Nigeria which had not rendered any service to the Appellant simply because the Federal Government had so directed was inevitable and was, therefore, incurred in the course of the Appellant's business which was petroleum operations.

19. The bank charges qualify for deduction under the general provisions of Section 10(1) of the Accounting PeriodPetroleum Profits Tax Act, 1959 as amended.

In Respect of Scholarship Expenses

20. In determining whether expenses on award of scholarship by the Appellant should be deducted in computing its Accounting PeriodAccounting Periodadjusted profits for 1973, the circumstances of the expenses must meet the requirements of Section 10(1) of the Petroleum Profits Tax Act. In other words, they must be expenses "wholly, exclusively and necessarily incurred" for the purpose of the Accounting Periodpetroleum operations of the Appellant.

21. The creation of a scholarship scheme is a statutory obligation to be observed by the Appellant. It is one of the things it had to perform as incidental to the carrying out of its business. It has no choice but to comply. Hence, the creation of the scholarship scheme and the award of scholarships to Nigerian citizens were incidental to the Accounting Periodpetroleum operations of the Appellant.

TEN OF THE CASES REFERRED TO

1. Ogbuanyinya v. Okudo (No. 2) (1990) 4 N.W.L.R. (pt. 146) p. 551
2. Carlen (Nig.) Ltd. v. UNIJOS (1994) l.n.w.l.r. (pt. 323) p. 631
3. Strong & Company of Romsey Limited v. Woodfield (Survey of Taxes), (1906) A.C. 448, 5 T.C. p. 215
4. Salami Afolabi & Ors. v. Governor of Oyo State & Ors. (1985) 2. N.W.L.R. (pt. 9) p. 734
5. Gulf Oil Company Ltd. v. F.B.I.R., Suit No. FHC/L/3A/83 (unreported) judgement delivered on 30th January, 1985
6. Potato Estates Ltd. v. Boland (B.M. Inspector of Taxes) (1948) 30. T.C. p. 267
7. Usher's Wiltshire Brewery Ltd. v. Bruce (Surveyors of Taxes) (1914) 6 T.C. p. 399
8. Bentleys, Stokes and Lowless v. Beeson (H.M. Inspector of Taxes) (1952) 33. T.C. p. 491
9. Lawal v. G.B. Ollivant (1972) 3. S.C. p. 124
10. Aya v. Henshaw (1972) 5. S.C. p. 87

REPRESENTATION

Chief F.R.A. Williams, S.A.N., with Dr. F.A. Ajayi, S.A.N. and F.R.A. Williams Jnr. For the Applicant

U.A. Inyang, Asst. Chief Legal Officer, Federal, with A.V. Nwangene, Senior Legal Officer, for the Respondent.

APPENDIX IV

BIBLIOGRAPHY

Ani, A.A. et al.: **Companies Income Tax and Petroleum Profits Tax in Nigeria.** Ibadan: University Press Limited, 1982.

Ariwodola, J.A.: **Personal Taxation in Nigeria,Fourth Edition.** Lagos: JAA Nigeria Limited, 2000.

Ariwodola, J.A.: **Companies Taxation in Nigeria, Fourth Edition.** Lagos: JAA Nigeria Limited, 2005.

Ogundele,E. Afe: **Elements of Taxation, First Edition: Lagos:** Libriservice Nigeria Limited, 1999.

Orojo, Hon J. Olakunle: **Company Law and Practice in Nigeria, Fifth Edition:** LexisNexis, Butherworths, 2008.

Chartered Institute of Taxation of Nigeria: **CITN Nigerian Tax Guide and Statutes,** Lagos: The Chartered Institute of Taxation of Nigeria, 2002.

Lekan Soyode & Sunday Kajola - **Silicon Publishing Company, Ibadan. First Edition 2006** TAXATION - Principles and Practice in Nigeria.

Joshua O. Oyebanji - **Frontline Publishers- Adesola Ibadan - Third Edition 2006** - Principles and Practice of Taxation in Nigeria.

Cuthbertson, K.: Macroeconomics Policy. **London: The Macmillan Press Ltd. 1979.**

Nightingale, K.: **Taxation Theory and Practice, Third Edition.** Pearson Education Limited, 2000.

Truett, L. J. & Truett, D.B.: **Macroeconomics.** St. Louis: Times Mirror/Mosby College Publishing, 1987.

Uche, R.U. & Adebiyi, K.A.:**Petroleum Accounting and Taxation in Nigeria. Second Edition,** Oakland: Alexander Books Associates, 2002.

Yerokun O. et al: **Nigerian Revenue Law Report (1. N. R. L. R. PART 1),** Nigerian Revenue Project Publications, 1997.

Sandford, C.T., Goodwin, M. and Hardwick, P.: **Administration and Compliance Costs of Taxation,** Fiscal Publication, Bath, 1989.

Deran, E.: **`Earmarking and Expenditures: A Survey and a New Test', National Tax Journal (December),** 1965.

Capital Gains Tax Act CAP C1, LFN 2004.

Companies and Allied Matters Act, CAP C20, LFN 2004.

Companies Income Tax Act CAP C21, LFN 2004.

Industrial Development (Income Tax Relief) Act, CAP 17 LFN 2004

Stamp Duties Act CAP S8, LFN 2004

Personal Income Tax Act, LFN 2004

Value Added Tax Act CAP VI, LFN 2004

Petroleum Profits Tax Act, CAP 354 LFN 2004

Companies Income Tax (Amendment) Act 2007

Federal Inland Revenue Service (Establishmenr) Act, 2007.

INDEX

A

Accounting period 169, 182, 204, 205, 230, 258, 259, 269, 317, 353, 354, 355, 356, 357, 358, 359, 360, 361, 362, 367, 368, 369, 370, 371, 373, 374, 375, 376, 377, 378, 379, 385, 386, 387, 388, 390, 392, 393, 394, 395, 397, 405, 407, 408, 410, 413, 433, 471, 472
Additional Assessment 42, 46, 100, 101, 102, 110, 113, 133, 194, 366, 377, 378, 380, 453, 454, 463, 464, 465, 466
Adjusted profit 169, 170, 189, 262, 354, 355, 356, 358, 360, 369, 375, 406, 433, 469, 471, 472, 474, 475, 476, 477, 478
Agricultural trade 154, 157, 159, 160, 181, 195
Annual allowance 193, 194, 196, 197, 200, 201, 202, 208, 218, 310, 311, 312, 361, 362, 370
Appeals 32, 36, 38, 40, 41, 100, 114, 256, 318, 330, 381, 382, 384, 388, 452, 461, 470
Apportionment 120, 126, 133, 177, 192, 365
Arms length principle 250
Artificial transaction 107, 106, 345, 356
Assessable profit 80, 124, 169, 172, 173, 175, 176, 177, 178, 179, 180, 181, 182, 192, 194, 195, 221, 250, 309, 320, 321, 322, 328, 355, 360, 375, 406, 407, 434, 453, 454
Assessable tax 358, 368, 369, 376, 378, 379, 406
Associated gas 63, 261, 336, 340, 401, 402, 438
Audit 14, 18, 19, 22, 23, 25, 77, 82, 84, 90 91, 92, 93, 94, 95, 96, 97, 98, 99, 100, 101, 102, 103, 105, 109, 110, 111, 112, 113, 114, 235, 376, 435, 436, 455, 463, 468
Audit checklist 94, 95, 109, 111

B

Balancing charge 118, 169, 176, 177, 178, 179, 194, 195, 207, 208, 362, 366, 367
Barrel 339, 340, 348, 370, 372, 395, 396, 399, 408, 409, 414
Basis period 150, 169, 190, 191, 192, 193, 194, 196, 200, 201, 209, 218, 353, 440
Board 2, 3, 4, 5, 6, 17, 19, 20, 21, 26, 47, 82, 83, 119, 219, 240, 244, 273, 309, 337, 346, 365, 407, 411, 434, 436, 451, 462, 471, 472, 473, 474, 475

C

Capital Allowance 12, 88, 132, 149, 150, 184, 190, 191, 193, 201, 202, 208, 212, 213, 215, 218, 219, 221, 248, 249, 267, 269, 303, 304, 320, 321, 322, 327, 329, 331, 332, 333, 335, 360, 367, 411, 412, 434, 462, 463
Capital allowances rates 201, 202
Capital Gains Tax Act 35, 118, 119, 134
Cessation of trade 150, 170, 172
Chargeable oil 341, 342, 344, 347, 354, 368, 369, 371, 373, 374, 405, 407, 469
Chargeable profits 179, 355, 368, 369, 375, 378, 379, 388, 404
Chargeable tax 368, 371, 407, 411, 413
Commercialisation 66, 162, 167, 434
Communication with other stakeholders 16
Company in partnership 149, 176
Concession 59, 60, 86, 198, 350, 351, 363, 368, 403, 404
Connected persons 127, 134, 277, 281, 285, 286
Corporate Residency 73
Cost Plus method 277, 283
Crude oil 336, 337, 338, 339, 340, 341, 348, 349, 354, 357, 368, 370, 371, 372, 373, 395, 396, 397, 399, 400, 401, 402, 403, 405, 408, 410, 438, 439, 440

D

Death 42, 43, 128, 129, 319
Decided case 15, 41, 58, 160, 177, 416, 425
Deduction at source 186
Deferral Method 205
Deferred Taxation 149, 203
Desk Audit 92
Development costs 350, 352, 435
Direct Taxes 50, 425, 437
Dividends 64, 151, 153, 154, 155, 168, 187, 231, 259, 261, 262, 264, 268, 293, 294, 298, 299, 394
Double taxation agreement 151, 209, 290, 291, 292, 293, 300, 330
Double Taxation Relief 300, 301, 302, 303, 317
Downstream Operations 435
Downstream operations 63, 202, 337, 340, 341, 405, 435, 436
Dry hole 351, 436

E

Ethical issues 18
Excise duty 350, 357, 369
Executives on Foreign Assignment 75
Exploration and drilling costs 349, 350, 351, 357
Export incentive 66

F

Federal High Court 39, 40, 41, 383, 384, 385, 471, 472, 473, 475
Field audit 92, 93, 94, 97, 98, 99, 102
Final Audit Report 93, 100, 115, 110
FIXED BASE OF BUSINESS
Fixed Base of Business 152, 243, 250
Foreign company 151, 241, 246, 308, 309, 312, 374, 375, 451
Foreign Direct Investment 75
Foreign tax 71, 75, 242, 246, 248, 292, 301, 303, 304, 436

G

G-Factor 407
Gas exploitation 63
Gas Industry Incentives 53, 401
Gas Transmission 63
Gas utilisation 63, 64, 202, 341, 395, 435
Government Take 396, 397, 400, 407, 409, 410, 412, 414
Guaranteed notional margin 396, 397, 398

I

Imposition 74, 120, 149, 151, 181, 276, 285, 335, 353
Income Tax Acts 119, 134, 436
Income Tax Relief 253, 254, 257, 262, 263, 289
Indirect Taxes 50, 437
Inflation 60, 316, 317
Infrastructure 27, 60, 76, 109, 419
Initial allowance 83, 85, 193, 197, 198, 199, 200, 201, 207, 308, 309, 310, 311, 312, 375
INSURANCE COMPANIES
Insurance companies 21, 70, 78, 319
Intangible drilling costs 342, 437
Intelligence unit 28, 94, 110, 116
Interim Audit Report 93, 99, 115
International dual residence 239, 240
Investigation/Intelligence Division 89, 105, 109
Investment allowance 53, 178, 195, 199, 201, 202, 213, 214, 215, 218, 229, 266, 409
Investment Tax Credit 355, 361, 362, 367, 369, 370, 404, 434
Investment tax credit 53, 63, 369, 370, 407

J

Joint venture 64, 275, 282, 287, 311, 313, 385, 395, 396, 402, 403, 405

L

Lease 9, 14, 22, 25, 29, 62, 83, 88, 134, 143, 163, 168, 206, 262, 264, 274, 286, 343, 344, 350, 351, 357, 358, 437, 438, 441, 477
Liability Method 205
Liquefied natural gas 61, 154, 157, 343
Loss relief 150, 169, 176, 179, 194, 265, 355, 360, 433

M

Market value 85, 86, 119, 120, 126, 127, 128, 129, 136, 138, 256
Memorandum of Understanding 78, 335, 336, 395, 396, 397, 405, 408, 410, 412, 414
MMcf 343

N

Natural gas 61, 154, 157, 337, 341, 343, 354, 357, 368, 402, 406, 407, 437, 439
Nigeria LNG Limited 253, 261
Nigerian company 150, 151, 152, 153, 154, 155, 158, 174, 240, 242, 244, 290, 291, 292, 301, 308, 318, 319, 320, 321, 323, 328, 330, 373, 374, 450
Nil provision 204
non-associated gas 438, 340, 402
Non-productive rents 343, 349, 357,369, 438
Non-resident individual 119, 121, 238, 246
Non-Tax Factors 76
Notice of Refusal 32, 36, 101, 114, 380
Notice of refusal 33, 36, 47, 100, 380, 388, 394

O

Objections 32, 77, 103, 318, 330, 388
Offences and Penalties 117, 223, 225, 233, 235, 253, 259, 283, 335
Oil Mining Lease 344, 357, 350, 438
Oil Prospecting Licence 350, 438, 439

P

Part disposal 124, 126
Payment date 386
Penalties 27, 28, 117, 223, 225, 226, 227, 228, 231, 233, 234, 235, 236, 253, 259, 260, 283, 335, 390, 391
Permanent differences 203, 204
Petroleum Investment Allowance 361, 362, 367, 370, 409, 413
Petroleum Operations 50, 344, 366, 469, 476

Petroleum Profits Tax Act
35, 153, 157, 181, 273, 274, 335, 336, 340, 359, 396, 401, 402, 404, 405, 407, 470, 471, 472, 473, 474, 475, 476, 477, 478
Pioneer Certificate 253, 254, 257, 261
Pioneer enterprise 258, 261
Pioneer Status 59, 88, 253, 255
Posted Price 335, 372, 396, 397, 399
Privatisation 440
Production costs 350, 352, 439
Production Day 253, 255, 261, 440
Production Sharing Contracts 335, 336, 361, 362, 368, 369, 370, 402, 403, 404, 405, 440
Profit Split Method 277, 280, 283

Q

Qualifying expenditure 66, 162, 167, 179, 190, 191, 192, 195, 197, 198, 199, 201, 202, 211, 215, 268, 308, 349, 357, 360, 361, 362, 365, 366, 367, 369, 370, 373, 374, 404, 440

R

Ratios 96, 97, 318, 330
Reconciliation meetings 93, 115
Reconstituted company 308, 309, 310, 311, 312, 374, 375
Repayment of tax 129, 155, 386, 387, 395
Resale Price Method 279, 277, 283
Resale price method 279, 280
Resident Companies 237, 239
Resident Company 246, 249
Resident company 158, 239, 240, 242, 243, 245, 247, 250, 251, 385
Resident individual 121, 238, 240, 246, 249
Residue of qualifying expenditure 362, 440
Revised Government Take
396, 397, 400, 410, 412, 414
Revised PPT 399, 400, 410
Roll-over relief 65, 132, 139, 142
Royalties 151, 187, 188, 231, 239, 240, 242, 276, 285, 294, 295, 343, 344, 357, 369, 440, 441, 449, 472

S

Separate Line Method 206
Small Business Rate 149, 185, 209
Special Businesses 316, 317, 319, 321, 323, 325, 327, 329, 331, 333

T

Tax audit 82, 84, 90, 91, 92, 93, 94, 95, 96, 97, 99, 100, 101, 103, 104, 105, 109, 110, 111, 112, 113, 115
Tax avoidance 15, 27, 50, 53, 54, 55, 57, 69, 74, 77, 105, 106, 112, 419
Tax evasion 16, 29, 50, 57, 58, 91, 97, 101, 104, 105, 107, 112, 115, 274, 302, 419
Tax fraud 91, 104, 105, 106, 112, 115, 276, 284
Tax haven 71, 72, 73, 74, 75, 106, 107
Tax incentive 68, 69, 79, 88, 401
Tax Inversion Penalty 400
Tax offsets 357, 369, 370, 406
Tax Planning 50, 51, 53, 55, 57, 59, 61, 63, 65, 67, 69, 71, 73, 75, 77, 79, 81, 83, 85, 87
Tax Reference Price 396, 397, 399, 408
Tax relief period
257, 258, 259, 260, 261, 263, 268, 269
Telecommunications 65
Thin Capitalisation 69, 70
Timing differences 203, 204, 205, 206
Tourism 65
Trade or business 34, 121, 122, 151, 152, 153, 154, 156, 157, 159, 160, 163, 170, 172, 176, 177, 179, 180, 181, 190, 193, 194, 195, 208, 209, 221, 242, 247, 249, 250, 251, 257, 260, 261, 268, 307, 308, 309, 310, 311, 360, 374, 375, 433, 451, 468
Transfer pricing 75, 272, 273, 274, 276, 277, 278, 281, 283, 284, 286

U

Upstream operations 63, 405, 441

W

Waiver or Refund of Liability 149, 168, 358
Will 443, 444, 445, 446