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TAX UPDATE

FIRS PROVIDES CLARIFICATION ON SUNDRY ISSUES IN THE FINANCE ACT RELATING TO COMPANIES INCOME TAX

Introduction

The Finance Act 2019 ("Finance Act") made several amendments to the Companies Income Tax Act 2004 (as amended) ("CITA") in relation to companies income tax. The Federal Inland Revenue Service ("FIRS") recently issued several circulars with a view to providing clarification on the amendments or to elaborate on the practical implications of such changes. One of such circulars is information circular No. 2020/04 titled "Clarification on Sundry Provisions of the Finance Act 2019 as it relates to Companies Income Tax Act" (the "Circular"). In this update, we have highlighted some of the key clarifications made by the FIRS in the Circular.

Amendment of Section 19 of the CITA

Prior to the enactment of the Finance Act, the provisions of section 19 of the CITA imposed 'excess dividend tax' on a company where a dividend is paid out as profit on which no tax is payable due to (a) no total profits; or (b) total profits which are less than the amount of dividend paid. The company paying the dividend shall be charged to tax at the rate of 30% of the dividend paid. This was applied by the FIRS irrespective of whether or not the income on the basis of which the dividend is paid is exempt from tax or has already been taxed. There were also judicial authorities in respect of this position.

To address the issues that have arisen from the section, the Finance Act has now amended the provisions to exclude the following classes of dividends (i) dividends paid out of retained earnings of a company, provided they are paid out of profits that have been subjected to tax under applicable laws (ii) dividend paid out of all tax-exempt incomes pursuant to any legislation; (iii) all franked investment income; and (iv) distributions made by a Real Estate Investment Company to its shareholders from rental or dividend income received on behalf of those shareholders.

To provide clarity on the implementation of the above amendment, the Circular provides that:

(1) In determining whether a dividend has been paid out of retained earnings, the profits of the current year disclosed in the financial statements shall be considered first. Where this profit is sufficient to cover the dividend for that accounting period, such dividend will not be treated as having been paid from retained earnings.

(2) The exemption is applicable even where the profits that generated such dividend accrued in a year other than the year in which the dividend was paid.

(3) Taxpayers are required to maintain a schedule to track the sources of dividend paid which should be included in their annual tax returns together with evidence of tax paid, where applicable.

Exemption of Small Companies from Companies Income Tax

The Finance Act exempts any small company with an annual gross turnover below 25 million ("Small Company") from paying companies income tax. In order to be able to take advantage of this exemption, a Small Company must have registered for income tax, filed its tax returns on or before the due date and complied with all other provisions and obligations stipulated under CITA. The FIRS has stated in the Circular that a Small Company that fails to meet the above conditions will forfeit the tax exemption. In addition, the FIRS may also impose the relevant penalties prescribed under the CITA and assess the defaulting company to companies income tax as appropriate, based on the information available to it.

The Circular also contains the following clarifications in respect of a Small Company:

- A Small Company is also exempted from tertiary education tax ("TET") as it will not have any assessable profit upon which the TET can be imposed as required under the Tertiary Education Trust Fund Act 2011.

- The exemption of the profits of a Small Company from income tax does not remove the obligation of the companies doing business with the tax-exempt company from withholding and remitting applicable tax on relevant payments due the company. The Small Company can request a refund of the tax (withheld and remitted) from the FIRS if it has fulfilled the conditions for enjoying the concession.

- The exemption does not

preclude a Small Company from its obligation to deduct and remit applicable tax when making relevant payments to other companies.

- Capital allowances on qualifying capital expenditure employed by a Small Company in the generation of its tax-exempt profits are deemed as fully utilised and cannot be carried forward even where the company ceases to be a Small Company in the future.

- Dividends received by a Small Company from another Small Company in the manufacturing sector are exempt from companies income tax as long as such payment is made in the payer's first 5 years of operation.

- To prevent the abuse of the "Small Company" concept, the FIRS is empowered to discountenance any disposition, arrangement or structure made for the purposes of reduction of tax liability especially where such is done in order to escape tax liability. For instance, where a company conceals its turnover for the purposes of obtaining tax benefit available to small companies, such a company may be prosecuted along with its directors and relevant principal officers and the taxes due shall be recovered with penalties and interest.

Profit on Exported Goods

The Finance Act amended the provision of the CITA which hitherto exempted profits on exported goods from companies income tax subject to prescribed conditions that the proceeds from such export were (a) repatriated to Nigeria; and (ii) used exclusively to purchase raw materials, plant equipment and spare parts. The Finance Act has now removed the need for such proceeds to be repatriated into Nigeria but retains the requirement for such proceeds to be used to purchase raw materials, plant equipment and spares, and provides that profits relating to export proceeds not utilised in the prescribed manner will be taxed proportionately. The Circular requires an eligible company to maintain a schedule and evidence of utilisation. Expenses incurred in relation to such exempt profits will not be tax-deductible.

Interest Deductibility

The Finance Act introduced interest deductibility rules ("IDR") into Nigerian tax law for related parties lending transactions. A Nigerian company or a fixed base of a foreign company in Nigeria that has incurred any interest or deduction of similar nature on loans or debts obtained from a foreign connected person is restricted to 30% of the company's earnings before interest, tax, depreciation and amortisation (EBITDA). The Circular has now clarified that:

- The IDR complements, and does not replace, the extant transfer pricing rules as taxpayers are to ensure that interest expenses comply with the provisions of the transfer pricing) regulations before applying the IDR.

- Interest must be directly incurred in respect of loans or debt obtained wholly, exclusively, necessarily and reasonably for the production of profits which are chargeable to tax, otherwise no portion of the interest will be an allowable deduction.

- EBITDA will be computed based on assessable profits before the deduction of interest expense (or similar charges).

- Where any amount of interest or deduction of similar nature has been disallowed by virtue of the restriction imposed under the IDR, such amount can only be carried forward for a maximum period of 5 years from the year for which the excessive interest expenditure was first computed.

- Failure to apply the IDR will lead to the imposition of the prescribed penalties and interest under the CITA.

- Although the IDR does not apply to a Nigerian subsidiary of a foreign company engaged in banking or insurance business, it applies to Nigerian banking or insurance companies that are parents to foreign companies, where the Nigerian company pays interest to that foreign subsidiary.

Year of Assessment Returns

The FIRS stated in the Circular that all tax returns due for submission before the coming into effect of the Finance Act must be prepared and submitted in accordance with the provisions of the CITA on respective due dates, before it was amended by the Finance Act. Consequently, such tax returns should not be adjusted to reflect the new provisions introduced by the Finance Act.

Minimum Tax

The CITA has been amended to provide that minimum tax shall be computed at a fixed rate of 0.5% of gross turnover excluding franked investment income. In addition, the minimum tax provision under the CITA is now applicable to all companies other than

(I) small companies;

(ii) companies carrying on agricultural trade or business; and

(iii) companies in their first 4 (four) years of business operation. The FIRS has stated in the Circular that, unlike before the enactment of the Finance Act, a company with at least 25% imported equity capital is no longer exempt from the payment of minimum tax.

Gas Utilisation (Downstream Operations)

The Finance Act has deleted the provisions of the CITA which previously allowed the deduction of interest payable on any loan obtained for a gas project with the prior approval of the Minister of Finance. Accordingly, the Circular has now clarified that interest on such loans shall only be deducted if

(I) the relevant income or profit is not exempt from tax;

(ii) it satisfies the wholly, reasonable, exclusive and necessary principle; and

(iii) it satisfies the IDR, where applicable.

The Circular further provides that a company that benefits from the pioneer status incentives under the Industrial Development (Income Tax Relief) Act 2004 is not eligible for the tax holiday granted to a company engaged in gas utilisation (downstream operations) under the CITA. The same applies to capital expenditure.

Filing and Payment of Tax

Section 77(5) of the CITA requires payment of tax to be made on or before the due date of filing, in one lump sum or instalments. Any taxpayer that wishes to pay in instalments prior to the due date of filing may do so, provided that the final instalment is paid on or before the due date of filing. A company that pays all of its taxes 90 days before the due date is entitled to a bonus of 2% in the case of a medium-sized company, and 1% for any other company of the tax due. Where a company is granted early payment bonus, it may set-off such bonus against its future taxes. Any tax due and unpaid by the due date of filing shall attract interest and penalties as provided in the extant tax laws.

Withholding Tax Rate on Construction Contracts

The Finance Act amended the CITA to provide that the withholding of tax ("WHT") rate on construction contracts for the roads, bridges, buildings and power plants is 2.5% instead of the previous 5%. The Circular provides the following clarification on the application of this provision:

- WHT rate on other forms of construction contracts and construction works (other than the actual construction work) subcontracted will continue to attract WHT at the rate of 5%.
- Where construction work and other activities that are preparatory, incidental or ancillary to that construction (e.g., survey, architectural design, soil test, environmental impact assessment, structural design, etc.) are embedded in a construction contract, the applicable WHT rate on the entire contract sum shall still be 2.5%.

Conclusion

The amendments made by the Finance Act to some provisions in the CITA and the clarification provided by the FIRS are far-reaching and largely welcome developments, as they have clarified so many ambiguous provisions. Taxpayers are advised to consult their tax advisers to understand how these provisions apply to them, optimise tax planning opportunities and ensure optimum tax compliance with the provisions of the CITA.

This update is for general information purposes only and does not constitute legal advice. If you have any questions or require any assistance or clarification on how the Circular could apply to you or your business, or require tax advice on any aspect of the Nigerian tax laws, please contact: taxteam@uubo.org.

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