10 December 2019

Global Tax Alert

Nigeria: Update on Finance Bill 2019

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Executive summary

Nigeria's 2019 Finance Bill (the Bill) was passed on 28 November 2019 by the House of Representatives after it had passed its third reading.[1] This vote followed the passage of the Bill by the upper chamber of the National Assembly (the Senate) on 21 November, following a public hearing held on 19 November.[2]

Further to the passage of the Bill by the House of Representatives, it is expected that the Joint Committee of the Senate and House of Representatives will meet to reconcile any pending issues on the Bill and then forward it to the President for his assent.

The Bill proposes changes that are primarily focused on raising additional revenues in order for the Federal Government of Nigeria (FGN) to meet its 2020 budget targets. Furthermore, as part of a continuing trend in recent years, the FGN, supported by the Federal Inland Revenue Service (FIRS), seeks to reform the domestic tax laws to better align them with international standard practices. Other objectives of the Bill are to promote fiscal equity, support small businesses and encourage investments in infrastructure and capital markets through tax incentives.

The Bill, if successfully passed into law, will significantly change the Nigerian tax regime by amending the Corporate Income Tax (CIT), Personal Income Tax (PIT), Petroleum Profit Tax (PPT), Withholding Tax, Capital Gains Tax (CGT), Value Added Tax (VAT), Customs Duties and Stamp Duties.

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The proposed changes, for the most part, are encouraging and suggest the FGN's willingness to promote business growth, particularly with the exemptions introduced for small and medium sized enterprises, and the reduction of the scope of Section 19 on Excess Dividend Taxes thereby eliminating the effects of double taxation. However, it is important to note that there are still some key areas in the tax regime that are yet to be significantly reformed such as the *Stamp Duty Act*, particularly with respect to uncertainties as to the party that should bear the stamp duty in many instances. Furthermore, confirmation as to the applicable rates on taxable instruments remains unresolved.

Details of the general changes as well as applicability by sector and their implications are outlined below.

Detailed discussion

Corporate Income Tax

Changes	Implications
▸ Profit of companies that are already subject to tax under one of the following: *CGT Act*, *PPT Act* and *PIT Act* will not be taxable under the *CIT Act*.	▸ This change is intended to eliminate the risk of double taxation.
▸ Taxable income derived by foreign companies now includes income from digital services, to the extent that such foreign companies have significant economic presence in Nigeria and profit can be attributed to such activities. In addition, profits arising from consultancy or professional services including technical and management services in relation to offshore services rendered by a person outside Nigeria to a person resident in Nigeria shall be taxed, to the extent that the company has significant economic presence in Nigeria and profit can be imputed to such activity.	▸ This provision was proposed mainly to equalize the treatment of foreign and domestic companies in relation to taxation of income from digital services as well as offshore services. The changes aim to guide the implementation of the taxation of digital services by upgrading the current income tax rules, which are significantly based on physical presence, to recognize the global trend of virtual businesses. This is expected to expand the tax revenue base of the country. However, it will be interesting to see how broadly the FIRS will interpret the definition of "economic presence," particularly, since the proposed provisions merely indicate that the Minister "may" provide guidelines in this regard. The change in offshore services seems to introduce a similar treatment to that given to passive income.
▸ There shall be no additional CIT on: – Dividends paid out of retained earnings, provided that the dividends are paid out of profits that have been taxed. – Dividends paid out of profits that are exempted from income tax. – Franked investment income. – Rental and dividend income distributed by real estate investment companies to their shareholders.	▸ In line with the comment above on the FGN's efforts to encourage local investments/support businesses by the elimination of double taxation i.e., via the Section 19 excess dividend tax on dividend distributions in excess of current taxable income, the list of income exempt from additional CIT has been expanded. The implications of this is that investors (domestic and foreign) should now be encouraged to reinvest profits into their businesses without fear of double taxation upon eventual repatriation of such previously taxed or exempt income.
▸ Clarity is provided on deductions not allowable for CIT purposes. Expenses incurred from related-party transactions within or outside of Nigeria, that are inconsistent with the transfer pricing regulations, will be disallowed for tax purposes.	▸ This change appears to be an attempt to closely align the CIT provisions as to allowable deductions with the general principles of transfer pricing, i.e., in line with the transfer pricing regulations; thereby mitigating the controversies resulting from the application of transfer pricing principles, particularly as it pertains to transfer pricing audits.

Changes	Implications
▸ The commencement and cessation rules for computing the income tax payable by new and liquidating businesses respectively, have been modified to incorporate actual year basis of taxation.	▸ The Bill clearly seeks to simplify the commencement and cessation rules. As is the case with many of the proposed changes in the CIT provisions, this change should reduce the risk of double taxation.
▸ The tax exemption on the transfer of assets at the Tax Written Down Value (TWDV) between related parties shall be rescinded if the asset in question is subsequently disposed of to a third party within 365 days of such initial transfer, and therefore subject to the applicable taxes.	▸ The Bill seeks to curb situations where related parties restructure and dispose of assets via untaxable share transactions for the sole purpose of avoiding taxation by including a safe harbor "cooling period." It would appear the provision seeks to deter the perceived aggressive tax planning in this regard.
▸ For companies under the pioneer status (tax holiday) incentive, only the TWDV of assets utilized during the pioneer period is allowed after the pioneer period has lapsed, i.e., post pioneer accelerated capital allowances would no longer apply.	▸ This provision deletes one of the benefits of obtaining the pioneer status incentives which currently allows for accelerated capital allowances post pioneer, as amortization of qualifying capital expenditure should begin from the first year of acquisition. This potentially, could reduce companies' interest in the pioneer status incentive, depending on the comparative impact on their business.
▸ Minimum tax rate amended to 0.5% of company turnover, and companies with turnover of less than NGN25 million in a year of assessment will be exempted from the minimum tax.	▸ This provision is intended to provide tax relief to small and medium sized companies (SMEs). However, given the limited revenue threshold, the impact of this provision in meeting its set objectives could be minimal.
▸ Increase in penalty for failure to file within the approved time frame from NGN25,000 to NGN50,000 for the first month of defaulting and NGN5,000 to NGN25,000 for each subsequent month (same applies to VAT returns).	▸ This change is meant to primarily drive compliance and serve as a deterrent to defaulters.
▸ Introduction of bonus tax credit of 2% (SMEs) and 1% (large companies) of tax payable for early payment of tax liability up to 90 days before the due date.	▸ In lieu of providing rules for provisional tax payments, and in line with the revenue generation objective, the FGN has introduced this incentive to motivate early remittance of the CIT due.
▸ Changes in regime for foreign loans: – The tax exemptions available for foreign loans have been modified, such that a 100% tax exemption no longer applies (maximum exemption reduced to 70%). – Thin capitalization rules will be formally introduced, which will apply to debt issued by a foreign connected person. – Interest in excess of 30% of earnings before interest, tax, depreciation and amortization (EBITDA) in an accounting period will be disallowed. However, Nigerian subsidiaries of foreign companies engaged in banking or insurance, are exempt from the new thin capitalization rules.	▸ Previously, Nigerian tax legislation did not specifically provide for thin capitalization. However, in practice, the general anti-tax avoidance provision in Section 22 of the *Companies Income Tax Act* (CITA 2004) was used as a tool to disallow interest expenses for companies deemed too thinly capitalized. The Bill thus seeks to formalize the current practice with a 30% of EBITDA restriction on interest on related party loans. The arm's-length nature of the interest rate applied on such loans should continue to be governed under the general transfer pricing regulations.

Capital Gains Tax

Changes	Implications
▸ A CGT exemption is introduced for reorganizations of businesses between related parties, provided that there are no disposals of assets from such reorganization within a 365-day period.	▸ This proposed amendment to the *CGT Act* is intended to align with the reorganization provisions which are currently only included within the CIT provisions of Section 29.
▸ Compensation for loss of employment below NGN10 million is exempted from CGT.	▸ This serves as a benefit to lower income earners, in the event of their employment termination.

Value Added Tax

Changes	Implications
▸ The rate for VAT is increased from 5% to 7.5%.	▸ The general consensus is that the Nigerian VAT rate is very low in comparison to other jurisdictions within Africa. With the emphasis on revenue generation for the Nation, this change is perceived to be an expedited manner in which to generate revenue for the Government. It is expected that further increases will occur in the future.
▸ A threshold of NGN25 million of turnover in a calendar year will be required for VAT registration.	▸ Consistent with the CIT exemptions for SMEs discussed in the CIT section above, this appears in line with the FGN's objective to reduce the tax burden on SMEs to help stimulate their growth.
▸ Intangible items are now covered under the meaning of supply and definition of goods and services.	▸ This is in line with the Government's objective of increased revenue generation. However, it appears to be in conflict with the general scope of the *VAT Act* as to imposition of VAT only on supply of goods and services.
▸ Introduction of "reverse charge rule" which requires recipients of goods and services supplied in Nigeria to self-account for VAT on goods purchased for nonresidents.	▸ The Bill aims to extinguish the recent controversy as to application of VAT on services provided by nonresident companies to Nigerian resident companies. Specifically, the courts have ruled in favor of the FIRS that a reverse charge mechanism should be deemed to exist notwithstanding the absence of such provisions in the *VAT Act*. Thus, the amendment in this regard, attempts to solidify the FIRS' position. This could, however, create an opportunity for taxpayers to argue otherwise, i.e., in the event the prior relevant cases are appealed to the Supreme Court based on general practice of preventing retrospective application of tax laws.
▸ Modification of the definition of "exported service" to include services rendered within and outside Nigeria by a person in Nigeria to a nonresident person or company.	▸ To specifically address any controversy around VAT on exported services with respect to the place of performance and recipient of such service.
▸ Removal of VAT charge on the sale or transfer of business, assets and management of related parties.	▸ This essentially includes a going business concern exception for imposition of VAT on qualifying business reorganizations.

Stamp Duty

Changes	Implications
▸ The definition of stamp has been expanded to include an electronic stamp or electronic acknowledgement. ▸ The meaning of instrument includes every written document including electronic documents.	▸ These amendments expand the scope of the Act to cover transactions that are concluded and executed electronically. This to some extent closes the gap in the Act and should generate further revenue for the Government. However, as earlier noted, key uncertainties as to the party that bears the tax cost, and the applicable rates on taxable instruments remain unaddressed.
▸ The inclusion of the provision as to the NGN50 one-off stamp duties on all electronic receipts or transfers for money deposited in any bank or with any banker, on any type of account, to be accounted for amounting from NGN10,000 upwards, except that monies paid into one's account or transferred electronically between accounts of the same owners by the owner within the same bank.	▸ This seeks to address the controversies associated with the policy issued by the Central Bank of Nigeria (CBN) in this regard, in a circular issued in January 2016. It also increased the amount threshold on which the stamp duty should apply (from NGN1,000 per the aforementioned CBN circular) to NGN10,000.

Customs and Excise Duties

Changes	Implications
▸ Goods imported to Nigeria will be subject to excise duties at the rates specified under the duty column in the fifth schedule of the *Customs and Excise Duties Act*.	▸ This is a clear indication that the FGN seeks to promote local production and discourage importation.

Personal Income Tax

Changes	Implications
▸ A Tax Identification Number (TIN) will be required as a precondition to open or operate a bank account for business purposes.	▸ Individuals will be required to provide their TIN as a precondition for opening or to operate a bank account for business operations purposes. The intention of this provision is to include a wider proportion of the population in the tax arena and to aid ease of tax remittance and compliance.

Key changes by sector

Real estate

The FGN has identified the real estate sector as one of the sectors with growth prospects. To encourage growth in the sector, the following key incentives were introduced in the Bill:

- Exemption of dividends paid by Real Estate Investment Companies' to their shareholders from the Excess Dividend Tax.
- Introduction of a specialized securitized lending regime to stimulate funding for the sector.

Financial services

The financial services sector plays a significant role in the tax revenue generation agenda of the FGN, as the FIRS continuously seeks to partner with banks to identify potential taxpayers. The insurance business space has also been identified as a potential growth sector by the FGN and the Government has introduced changes in the Bill to support growth in the sector. Key changes in the Bill that will generally impact the financial sector include:

- Banks are mandated to request the TIN of companies opening a new account and those with already existing accounts. This is aimed at harmonizing both bank and tax databases to enhance tax administration and compliance.
- Profits resulting from regulated security transactions shall be subject to CIT, while the transfer of shares and securities in a regulated security lending transaction shall not constitute a disposal and as such, shall not be subject to tax.
- Nigerian subsidiaries of foreign companies engaged in banking or insurance, are exempt from the new thin capitalization rules.
- Insurance companies can now carry forward their losses indefinitely and are allowed deductions for unexpired risks on a time apportionment basis. In addition, certain restrictions on allowable restrictions specific to the insurance sector have now been removed such as deductions for unexpired risks.

Small and medium enterprises

SMEs (small enterprise- turnover of less than NGN25 million annually, medium enterprise- turnover between NGN25 million and NGN100 million annually) constitute the bulk of businesses operating in Nigeria. The Bill proposes a number of incentives to encourage growth of SMEs in Nigeria, as follows:

- Profits made by small scale businesses are to be exempted from tax. Furthermore, dividends received from small companies in the manufacturing sector are exempt from tax.
- Small- and medium- sized companies are subject to a reduced CIT rate of 20%.
- Bonus of 2% of tax payable for medium-sized entities for early payment of CIT up to 90 days before the due date.

Telecommunications, media and technology

As with many other jurisdictions across the globe, Nigeria has struggled to formulate a regime that effectively taxes digital activity within the country, given that the current tax laws are mostly dependent on physical presence. The Bill seeks to expand the tax provisions on the determination of a fixed base/permanent establishment for foreign companies with digital operations in Nigeria. Specifically, digital and electronic services shall be subject to CIT in Nigeria, to the extent that such foreign companies have a significant economic presence in Nigeria, and profit can be attributable to such activities.

Oil, gas and energy

The oil and gas sector is still the dominant sector of the Nigerian economy. Therefore, as expected, the Bill introduces changes to increase revenue raised from the sector, as highlighted below.

- Dividends paid out of petroleum profits are now subject to a 10% withholding tax, thereby repealing section 60 of the *PPT Act*.
- For entities utilizing the Pioneer Status regime, only the TWDV of qualifying capital expenditure shall be carried forward to the post-pioneer period.

Consumer goods

The FGN continues a trend of seeking to increase revenues from indirect taxation, clearly evident from the increase of the standard VAT rate by 50%, i.e., from 5% to 7.5%. Given the nature of the consumer goods sector, it is often the most impacted by such changes, which includes:

- Application of excise duties at the rates specified under the duty column in the fifth schedule of the *Customs and Excise Duties Act*, on goods imported to Nigeria.
- An expansion of the list of products that are exempt from VAT to include: flour and starch, fruits, live or raw meat and poultry, milk, nuts, pulses, roots, salt, vegetables, water and locally manufactured sanitary towels.

Endnotes

1. Comments Arising from the Recent Passage of the Bill by the House of Representatives on 28 November 2019:
   - The House of Representatives, during a plenary by the House Committee of Finance, also passed the Bill after its third reading. This process resulted to the lower chamber of the National Assembly consenting to the proposed changes in the Bill, particularly as to the increase in the VAT 5% to 7.5%.
   - The House also clarified that the responsibility of collection of the NGN50 stamp duty (as discussed above) should be transferred to the FIRS. This clarification was not addressed in the Bill, which then suggested (prior to the clarification provided by the House of Representatives) that the Nigerian Postal Services will continue to collect the stamp duty, in line with the aforementioned CBN circular.
2. The passage of the Bill by the Senate comes after the President of the Federal Republic of Nigeria, Muhammadu Buhari forwarded the Bill for passage into law by the National Assembly on 14 October 2019.

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EYG no. 005607-19Gbl

1508-1600216 NY
ED None

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