

# Nigeria Could Lose Over 5 Trillion Naira in Tax Revenue

## If the Bill seeking to compel private companies to become public entities is enacted into law

By Taiwo Oyedele



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### Overview

A Bill known as “Private Companies Conversion and Listing Bill, 2013” is undergoing legislative proceedings at the National Assembly. The Bill seeks to compel private companies to convert to public companies by becoming listed on the Nigerian Stock Exchange (NSE). The thresholds for the mandatory conversion are: shareholders fund in excess of 40 billion Naira (around USD 250 million), turnover or total assets of 80 billion Naira (about USD 500 million). A private company that meets any of the thresholds must be converted to a public company and be listed on the NSE within 12 months. As stated in the Bill, the conversion is aimed at promoting growth for both the company and the Nigerian capital market.

According to the Bill, asset value of a company is based on the gross value of the company's assets as recorded in its balance sheet at the end of the last audited financial year; and annual turnover is based on the gross revenue of the company arising from the sale and rendering of goods and services; and the use of the company's assets in a manner that yields interest, royalties and dividends. The Bill extends the definition of private companies beyond the provisions of the Companies and Allied Matters Act (CAMA) to cover any body corporate, firm or partnership or any other entity. A fine of 10% of annual turnover and imprisonment of at least 2 years may be imposed for non-compliance.

For a period of five years, a company that lists at least 40% of its issued share capital will be eligible for a tax incentive at a rate up to one-third of its applicable income tax; listing of 30% of issued share capital is eligible for a tax incentive of up to one-fourth of applicable income tax; while a listing of 20% of issued share capital is eligible for a tax incentive at a rate up to one-eighth of applicable income tax. Expenses incurred in compliance with the Bill will be deductible for tax purposes in addition to the existing capital gains tax exemption on share transactions.

## What does this really mean?

On face value, the Bill looks like a good initiative but a careful analysis suggests otherwise. Nigeria with a GDP of USD 510 billion is the largest economy in Africa but the country's capital market with a total capitalisation of about USD 80 billion is dwarfed by the Johannesburg Stock Exchange with market capitalisation of over USD 1 trillion as at the end of 2013. South Africa did not achieve this by forcing private companies to list but rather through impeccable regulatory enforcement. The country is ranked 1st in the world in terms of regulation of securities exchanges in the World Economic Forum's Global Competitiveness Survey for 2013-2014.

Compelling private companies to list their securities contradicts extant laws such as Section 25 of the Nigerian Investment Promotion Commission Act which states unequivocally that "no person who owns, whether 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".

Another issue is whether the NSE has the absorptive capacity to cope with such a large scale listing. Here is a market that struggles to absorb just 5% of Dangote Cement at the time of listing in 2010. How much free cash flow do we have in the economy or that foreign investors will be willing to inject? Due to the frenzy of a new listing, existing shareholders of listed entities will seek to sell off their stocks to buy the new shares. This in turn will depress the market given its relatively small size. Institutional investors like pension funds, banks, insurance and investment funds all have paucity of equity investable cash given the various legal restrictions and attractiveness of the money market that offers high returns and a much lower risk.

Based on the 2013 tax revenue profile, oil and gas companies in Nigeria (all private) and non-oil private companies paid over 3 trillion Naira in income taxes to the Federal Inland Revenue Service. If these companies list at least 40% of their shares and hence enjoy a reduction of one-third of their income tax rates, then Nigeria will lose at least 1 trillion Naira annually for five years.

Some media reports credited to the sponsors of the Bill claim that private companies do not pay tax. This is difficult to understand given that the largest taxpayers in Nigeria are in fact private companies such as MTN and Nigeria LNG. In any case, it is counterintuitive for the sponsors of the Bill to expect increase in tax revenue by granting tax waivers that do not necessarily increase the country's tax base.

## Some questions to be answered

1. What level of research and empirical data has been gathered to support this proposal? Or is this simply a move to satisfy a few people who are keen to invest in some private companies?
2. If this is meant to enable Nigerians participate in the prosperity of some private companies that are doing well, then it should be noted that Nigerians will also be participating in the losses of those that are not doing well. But the question is who says that securities listed on the NSE will be acquired by Nigerians given that a significant part of available fund in the stock market is from external sources?
3. By granting incentives to companies who list under the new law, what happens to existing listed companies? And would small companies that fall below the listing threshold not be disadvantaged and be unable to compete? In fact, this Bill can hold back voluntary listings so it must be dispensed with as quickly as possible.
4. If a private company with huge investment outlay such as in power generation or upstream petroleum operation is forced to list during investment phase where it is not yet making profits, the share price may continue to fall with the risk that low price may lead to unwanted hostile takeover. Will there be safeguards against this?
5. What happens if a private company decides to split its operations to ensure that the threshold is not exceeded? What about using debt financing to avoid exceeding the shareholder fund threshold or off balance sheet asset leasing to stay within total assets limit?
6. Would there be exemptions for subsidiaries and intermediate holding companies if their ultimate parent entities are listed? What if a not-for-profit entity exceeds the listing threshold?

7. What happens if a listed company subsequently falls below the listing threshold or fails to comply with listing obligations that should normally result in delisting? Can such entities be delisted or are companies now to be listed for life?
8. Would private companies that become public by virtue of having a minimum of 50 shareholders rather than by listing be affected by the new law?
9. If this proposal was such a good idea, why did government not take the lead by listing some of the government corporations?
10. Why are we quick to invite foreign investors to come to Nigeria and then we turn around and accuse them of wrongdoings for making profits even though they are doing legitimate businesses?

## **Where do we go from here?**

Public listing by a company is not a spontaneous decision but a strategic and complex process the timing of which must be right for the individual company in addition to having a clear purpose for the capital that will be raised. There can be no viable primary market without a robust secondary market.

To compel private companies to become public entities is disguised indigenisation particularly to foreign investors. The Bill, if enacted into law will not only be draconian but will also lead to significant tax revenue loss to government and certainly discourage existing and future investments in Nigeria by both domestic and foreign investors.

The Bill should not be passed into law. Listing on the stock market should be left to market forces. Government should focus on providing the requisite regulations and oversight of the capital market to promote transparency and good governance. If we deal with market infractions such as share manipulation, insider trading, circular trading and promote good practices, reduce transaction costs, extend promoters lock-in period, relax stringent listing conditions, and address exchange control restrictions for foreign investors, then growth will happen naturally as we have seen in other climes.

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