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PwC Tax Alert

FIRS Circular on Sundry Changes

July 2021

Background

The Federal Inland Revenue Service (FIRS) issued a circular to clarify some of the changes to the Companies Income Tax Act (CITA) introduced by the Finance Act (FA) 2020. This circular is an update of an earlier circular issued in May 2020 on sundry changes to CITA introduced by the FA 2019 ("2019 circular"). Please refer to the 2019 circular here and our tax alert here for an understanding of the issues raised.

Highlights

We have highlighted the updates by the FIRS in the 2020 circular below:

1. Interest relating to Agricultural loans

FA 2020 revised the conditions for the tax exemption on interest on loans granted by a Bank for agricultural purposes. Qualifying business must be carrying out primary agricultural production and not just general agricultural trade or business. Minimum moratorium period in the loan agreement was also reduced from 18 to 12 months and the rate of interest on loan cannot exceed base lending rate.

Primary agricultural production was defined as primary crop production, primary livestock production, primary forestry production and primary fishing production.

2. Small companies and CIT

Small companies with gross turnover not exceeding NGN 25 Million are exempt from CIT. FIRS listed the conditions necessary for getting exemption from tax and stated that a small company which defaults in meeting the conditions shall be liable to penalties.

FIRS reserves the power to assess the small company to an administrative or best of judgment (BOJ) assessment where the company refuses to file CIT returns as and when due.

3. Small companies and TET

The amendment to the TET Act now expressly clarifies that small companies are not liable to TET.

4. Donations for Pandemics and Natural disasters

Donations made in cash or kind to any fund set up by the Federal, State or any agency designated by the Government in respect of any pandemic or natural disaster, shall be tax deductible to a maximum of 10% of assessable profits after all other allowable donations (the circular erroneously uses 'deductions' here as against 'donations'). Documentary evidence of such donations shall be provided in proof of tax deductibility.

In the circular, the FIRS used an illustration to demonstrate how to apply the three restrictions applicable in determining deductible donations; namely:

- donations to educational institutions - 15% of total profit before deduction of donations
- donations to non-educational institutions – 10% of total profit before deduction of donations
- donations made in cash or kind to fund set up by (any agency of) the government in respect of any pandemic or natural disaster – 10% of assessable profits after deduction of other allowable donations

5. Expenses incurred in earning exempt income

CITA disallows expenses incurred to generate exempt income. However, there is no clarity on the amount of expense to be disallowed where the expense is incurred to earn both taxable and non-taxable income. In the 2019 circular, the FIRS recommended the use of a pro-rata approach to determine the expense to be disallowed in such cases.

In the 2020 circular, the FIRS proposes a more detailed method for determining expenses attributable to tax-exempt income, as follows:

i. cost directly and solely incurred to earn each class of income shall be separated, e.g. cost of goods sold, staff remuneration, professional fee, etc.

ii. costs incurred for both classes of income shall be apportioned based on appropriate allocation keys e.g. rent – floor space occupied; staff remuneration - man-hour

iii. Where appropriate allocation key cannot be determined, allocate using pro-rata basis

6. Penalty and Fines

Penalty or fines imposed pursuant to a legislation enacted by the National Assembly or a State House of Assembly shall not be allowed for tax purposes. Any expense incurred for the violation of laws and subsidiary legislations or regulations made pursuant to the legislation. eg.TP Regulations will not be deductible.

7. Payment of Minimum Tax

Minimum tax is computed at a fixed rate of 0.5% of 'gross turnover' with the exclusion of franked investment income. For tax returns that fall due for any year of assessment from 1st January 2020 up to December 2021, the minimum tax rate is 0.25%.

Based on the circular, gross turnover, for the purposes of minimum tax has been amended to include all incomes from operating activities, sales of goods, supply of services and all other investment income as reflected in the financial statements, books or records, but which does not include increases relating to contributions from equity participants.

8. Gas Utilisation

Section 39 of CITA as amended provides incentives for companies engaged in a trade or business of gas utilisation in downstream operations, this includes an initial three years tax free period renewable for another two years, additional investment allowance, etc.

The circular clarifies that the gas utilisation incentive will now apply to a trade or business (of gas utilisation in downstream operations). Hence, if a company engages in more than one business, of which one qualifies for the gas utilisation incentive, the incentive will be limited to only that business.

FIRS clarified that a company engaged in both upstream petroleum operations and downstream gas utilisation which has enjoyed similar incentives under the Petroleum Profits Tax Act (PPTA) cannot benefit from the incentives provided under section 39 of CITA. Similarly, a company that has enjoyed the incentives under section 39 of CITA shall not claim similar incentives under any law in Nigeria, e.g. the pioneer tax incentives in the Industrial Development (Income Tax Relief) Act (IDITRA).

9. Taxability of Interest Payable on Loan

Section 39(1)(e) which required the prior approval of the Minister for the deduction of interest payable on any loan obtained for a gas project has been deleted by the FA 2020.

Now, such interest shall only be deducted if it satisfies the WREN test, if it is incurred to generate taxable income, and also satisfies the interest deductibility rules introduced by section 24(a) and the Seventh Schedule of CITA.

10. Self-Assessment of Tax Payable

Generally, companies are to file tax returns with evidence of payment of tax due. However, where the company, by deliberate and dishonest act, fails to fully declare the true and correct amount of tax payable or submits an incorrect statement, the company is liable to pay outstanding tax including penalties and interest from the date in which the tax return was due.

In the circular, FIRS gave examples of deliberate and dishonest act to include:

i. Inflating expenses or other tax deductions
ii. Suppressing of income
iii. Deliberately omitting information on the tax returns

FIRS also stated that additional tax arising from a desk review, tax audit, tax investigation or any examination by the Service shall attract penalty and interest, accruing from the date the incorrect return was due.

11. Computation of Penalty and Interest

Penalty and interest will be imposed from the date an incorrect return was due. As such, it is required of every taxpayer to ensure the right amount of taxes are paid.

12. Time Within Which Tax is to be Paid

Section 77(2) of CITA LFN 2004 was amended to reduce the time within which tax is to be paid from 60 days to 30 days after the service of Notice of Assessment. Therefore, companies are to pay tax assessments not objected to or appealed within thirty days of service.

13. Definition of Public Character

Public Character has now been defined to mean any organisation or institution:

a) that is registered in accordance with relevant law in Nigeria
b) does not distribute or share its profit in any manner to members or promoters.

The registration must be under the relevant law of the Federal, State or Local Government in Nigeria. Furthermore, the profit of such institutions should not be paid or transferred directly or indirectly by way of dividend or bonus to its members, trustees or promoters.

Takeaway

Minimum tax

In defining gross turnover for minimum tax purposes, the FIRS did not consider fully the phrase "arising in the course of the operating activities of an entity". Taxpayers may argue that inflows to be included in gross turnover for the purpose of calculating minimum tax should be limited to income from the business' primary activities. They may therefore argue that receipt of interest, rents and royalties should only be subjected to minimum tax if the company earns such income actively.

Exemption for Agricultural Trades or Businesses

One of the qualifying conditions for minimum tax exemption is carrying out "agricultural trade or business" as defined in CITA. In the FA 2020, the section that defines 'agricultural trade or business' (section 11(4)) has been replaced with 'primary agricultural production'. Hence, companies that operate in the agricultural industry that previously enjoyed minimum tax exemption need to revalidate whether they still qualify for minimum tax exemption based on the more restrictive definition of "primary agricultural production".

Similarly, companies in the "agro-allied" industry that enjoyed an exemption from the ⅔ of total profit restriction on claim of capital allowance will need to reevaluate whether they still qualify for this exemption based on the definition of primary agricultural production.

Small companies and CIT

The FIRS has modified its position slightly in this circular by deleting its previous statement in the FA 2019 circular that a company that defaults in meeting the conditions will forfeit its tax exemption. The new update brings the circular in line with the law as a small company can be liable to penalties for other defaults while enjoying tax exemption.

Expenses incurred in earning exempt income

The new method introduced by the FIRS for allocating expenses is more detailed than its previoius circular. Taxpayers should keep track of expenses incurred solely to generate exempt income and disallow them. Suitable allocation keys should be determined and used to apportion the joint costs. Apportionment using the ratio of tax-exempt income to total income should be a last resort for expenses for which a more suitable allocation key cannot be determined.

Penalty and Fines

The FIRS has now clarified that penalties or fines imposed pursuant to a National or state legislations, as well as violation of subsidiary legislations will be disallowed. Though CITA does not mention subsidiary legislations, disallowing penalties under the principal Act would mean that any penalty under a subsidiary legislation made pursuant to the principal Act should also be disallowed.

Self-Assessment of Tax Payable

The FIRS' has now given examples of deliberate and dishonest acts. The concern here is that the FIRS will be the one to determine whether an act was done deliberately or dishonestly, which brings in subjectivity to the process. It is hoped that the FIRS will only seek to characterise taxpayers' actions as deliberate and dishonest when there is clear evidence of such. Otherwise, the position of the FIRS could be challenged at the Tribunal and in the courts.

Public Character

Organisations who are engaged in ecclesiastical, charitable and educational activities who want to claim the tax exemption under CITA must now be registered in Nigeria in order to be of public character. However, the word registration used in the law is not necessarily incorporation. The restriction on distribution of dividends and bonus will likely exclude limited liability companies from qualifying for the exemption.

This circular clarified some of the issues raised by the previous circular and expounds on many of the changes from the FA 2020. However, some key issues remain unaddressed, such as the FIRS' interpretation of the excess dividend tax provisions and the thin capitalisation rules. Please see our comments on these in our previous alert.

For a deeper discussion, please contact:

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