

Let there be roads...

Matters arising from the Road Infrastructure Development and Refurbishment Investment Tax Credit Scheme Order, 2019



By Taiwo Oyedele

... if diligently implemented the Scheme can bring huge benefits to all stakeholders. It should prevent budget padding, reduce contract inflation, cut down political patronage and rent-seeking, ensure timely project completion, reduce abandonment of projects and address sub-standard quality of work. It should however be worthwhile for the private sector and not be at excessive cost to the government.

Context

According to the Infrastructure Concession Regulatory Commission, Nigeria has about 195,000 km of road network out of which about 32,000 km are federal roads and 31,000 km are state roads. In total, only about 60,000 km are paved leaving 135,000 km of road untarred. A large proportion of the paved roads are in bad conditions due to poor maintenance.

President Muhammadu Buhari on 25 January 2019 signed a 10-page Executive Order No. 007 known as the “Companies Income Tax (Road Infrastructure Development and Refurbishment Investment Tax Credit Scheme) Order, 2019” described as a Public-Private Partnership intervention to enable government leverage private sector funding in a manner that creates value for money through private sector discipline. The Order is accompanied by an 11-page Regulation made up of First Schedule on the Administration and Operation of the Scheme while the Second Schedule contains a sample MoU for eligible road projects.

Legal framework

The Order references the powers conferred on the President under Section 23(2) of the Companies Income Tax Act (CITA). The section provides that the President may exempt by order (a) any company or class of companies from all or any of the provisions of this Act (CITA); or (b) from tax on all or any profits of any company or class of companies from any source, on any ground which appears to it sufficient.

Highlights of the Order

The Scheme will be in force for a period of 10 years from date of commencement of the Order. A Management Committee will be set up to implement and administer the Scheme. Participants and beneficiaries must be registered by the Committee which shall have discretion over costs that may be allowed as part of the Project Cost. In addition, there shall be an MoU and contract documents between participants and the Minister of Finance as Chairman of the Committee. Completion of each road project shall be between 12 to 48 months.

Participants in the Scheme shall be entitled to tax credits for the project cost incurred including a single uplift equivalent at the prevailing CBN monetary policy rate plus 2 per cent. The uplift shall not constitute taxable income in the hands of a participant or beneficiary. Costs incurred on roads under the scheme are not eligible for any other allowances or tax relief.



The aggregate professional fees admissible as part of Project Cost shall not exceed 1.25% of cost of construction or refurbishment costing N10 billion and above.

Eligibility

Eligible participants are companies or corporations established under any law in force in Nigeria. This includes a pool of companies operating through a Special Purpose Vehicle registered with the Securities and Exchange Commission as an infrastructure Fund and Institutional Investors such as Pension Fund Administrators.

Eligible road means any road approved by the President on the recommendation of the Minister of Finance based on roads presented to the Minister by the Road Scheme Management Committee, and published in the official Gazettes of the Federal Republic of Nigeria.

Eligible project cost means any expenditure wholly, reasonably, exclusively and necessarily incurred by a participant for the construction or refurbishment of an eligible road as certified by the Committee. This includes cost of road construction or refurbishment, road maintenance for a period of 5 years following completion of construction or refurbishment, professional fees, and necessary and reasonable variation certified by the relevant regulatory authority. Cost must be obtained through competitive bidding process and must follow set procedures of the Bureau of Public Enterprises for certifying and approving procurement for federal government contracts.

Procedures

Eligible participants are to submit written applications to the Committee to include a valid Tax Clearance Certificate (TCC) issued by the FIRS; latest audited financial statements of Corporate Sponsor(s); and project cost and timelines bids to include design and specification for the identified road project. A Fund Manager must present evidence of registration with SEC and authorization letter to act for and on behalf of a pool of companies.

The Committee will apply the set procedures of Ministry of Works in approving project cost and completion timelines. Participants are to apply to the FIRS for a Road Infrastructure Tax Credit Certificate annually based on approved costs. Once issued, the certificate becomes valid for use against the corporate income tax (CIT) in and from the relevant fiscal year, in which the project cost is incurred, until it is fully utilized. The utilization is not automatic as participants must apply to the FIRS to claim the credit. The amount of credit to be utilized in any given year is limited

to 50 per cent of the CIT payable by the participant or beneficiary for that year of assessment except with respect to roads in an Economically Disadvantaged Area which is not subject to the limitation.

The Road Tax Credit is a tradable instrument and may be sold in whole or in part to a willing buyer on a relevant Securities Exchange or such other approved transaction. Every sale or transfer is subject to the approval of the Committee. Various actions required by government including issue of Tax Credit Certificates by the FIRS are deemed to be automatically done after 14 days in line with the Executive Order 01 of 2017.

Governance

The Regulation to the Order provides for a Management Committee to be chaired by the Minister of Finance while the Minister for Works will act as the Deputy Chairman. Other members are drawn from both ministries and other MDAs viz: Trade and Investment; Justice; BPE; FIRS; NIPC; SEC; Infrastructure Concession Regulatory Commission; Budget Office; NBS; NSIA; the Presidency; and any other person as may be deemed necessary by the Minister of Finance.

The ministry of finance may engage consultants to undertake value engineering studies to ensure value for money. Committee members are to apply the principles and procedures as laid down by their respective MDAs in performing their functions.

Reporting

The Tax Credit may qualify as an assets in a participant or beneficiary's accounts in line with IFRS. The Committee is to facilitate the preparation by the FIRS of annual returns of all Roads Tax Credits issued and utilized in every fiscal year which may be submitted by the finance minister to the Federation Accounts Allocation Committee and potentially to the National Assembly.

The grey areas

The Order raises a number of key questions:

1. Are eligible roads limited only to federal roads given that states and LGs are entitled to a share of CIT revenue?
2. Is borrowing cost eligible? And foreign exchange differences, both realized and unrealized, given that road projects would inevitably involve foreign inputs? It appears the intention of the uplift is to compensate for borrowing cost or time value of money spent but it does not go far enough as it is a single uplift while claims against tax could take several years.

3. How will internally generated cost be treated given that it cannot be subject to a competitive bid – and should it be cost to company or cost that would have been charged to a third party?
4. Why would any institutional investor such as a PFA participate given that their funds under management are exempt from CIT and selling the Tax Credit will give them lower than risk-free returns?
5. Why is the eligibility limited to organisations established under Nigerian laws and liable to CIT to the exclusion of foreign investors and oil companies taxable under the PPTA?
6. How will the 10yrs sunset be determined? Will projects started and still in progress by year 10 be eligible? And utilised credits?
7. Any gains or losses on disposal shall be taxed in the manner prescribed by the applicable tax legislation. Will this be capital gains tax, CIT or other taxes?
8. In the event that a project or project cost is not approved, how will the associated cost be treated? And professional fees that exceeds the cap of 1.25% or maintenance carried out after 5 years? In practice FIRS takes the rebuttable view that unapproved costs are also not allowable for tax purposes?
9. Does fiscal year cover any tax payable in that year or only taxes which become due in the year? Will this be different from WHT credit utilization?
10. Will the Tax Credit be treated as tax revenue by government or tax expenditure? And in any case how will this be reconciled with revenue and capex budgets of federal, state and LGs?

My two kobo

With the impending new minimum wage bound to put more pressure on funding available for capital spending, so this is generally a good idea. It should be a win-win situation for government to partner with the private sector and

if diligently implemented can bring huge benefits to all stakeholders. It should prevent budget padding, reduce contract inflation, cut down political patronage and rent-seeking, ensure timely project completion, reduce abandonment of projects and address sub-standard quality of work. It should however be worthwhile for the private sector and not be at excessive cost to the government. As currently drafted it does not appear attractive except if borrowing cost is eligible as part of project costs. As an incentive, eligible roads could be named after the relevant company.

To ensure the efficiency of the private sector, the Scheme should be designed to limit discretion by the Committee and avoid conflict of interest by its members. In addition, there should be an independent audit and not just by ministries as contained in the Order.

There could be a legal challenge as granting a waiver or exemption under CITA as provided for under S23 is not the same as granting of credit for road projects. Government should consider a Plan B in case the Scheme is successfully challenged.

Another concern is continuity in the event of a change in government before expiration of the Scheme. Hopefully as the Scheme idea predates the current government it would be sustained into subsequent regimes.

In principle, how much the private sector can invest on roads under this Scheme is limited to about half the annual CIT revenue which has ranged between N600B and N1T in the past 5 years. To effectively address the funding of roads and other infrastructure projects, other initiatives involving private sector funding with cost recovery from independent revenue sources should be explored.

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