PwC Tax Alert

FIRS Information Circular on commencement and cessation rules, and business reorganisation

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Background

The Finance Act 2019 was signed into law on 13 January 2020, and introduced some changes to the commencement and cessation rules for companies, as well as business reorganisation rules. Subsequently, the Finance Act 2020 was signed into law on 31 December 2020, introducing similar commencement and cessation rules for individuals and unincorporated enterprises.

The FIRS has issued a circular (Circular 2021/10) dated 3 June 2021 in respect of the above subject, replacing its earlier Circular 2020/06. This new circular retains most of the points in the earlier circular (see PwC's Tax Alert on the previous circular here). However, the new circular includes clarification on the rules for individuals and unincorporated enterprises, as well as other changes in their interpretation of some provisions. We have highlighted these key changes below:

Commencement and cessation rules for companies and enterprises

The FIRS now clarifies that the basis period for the first year of assessment (YOA) is a company's first accounting period, even where the accounting period exceeds 12 months. Thus, where a company commences business on 1 October 2019 and makes up its first accounts to 31 December 2020, the first basis period will be the 16-month period from 1 October 2019 – 31 December 2020.

The FIRS had previously stated that a company should prepare its first tax returns from when it commences business on a pro-rata basis up to its first accounting "year-end", meaning that the company in the above example would have had to prepare tax returns for 1 October 2019 - 31 December 2019, and also for 1 January 2020 - 31 December 2020.

The new position is in line with the law and avoids the administrative inconvenience of filing separate returns for a single YOA. However, the Companies Income Tax Act (CITA) does not provide for the claim of capital allowances for basis periods that exceed 12 months. Therefore, this clarification may imply that where a company's first basis period exceeds 12 months, it may only be able to claim capital allowances for 12 months, for that period.

From a PITA perspective, the FIRS clarified that:

1. An enterprise that commences business should apply the Preceding Year Basis (PYB) for all the years of assessment during commencement.
2. With respect to the first year of assessment, the basis period of an individual or enterprise is from commencement of business to the end of the first accounting period, even where this exceeds 12 months (similar to companies).
3. An enterprise that commenced business in 2019 (before the effective date of the FA 2020) may have a gap or an overlap of tax years when transiting from the old rules to the new rules.
4. In respect of cessation, the final tax year is from the beginning of the last accounting period to the date of cessation. The cessation returns for enterprises are due for filing 3 months after the cessation date.
5. Unlike the old cessation rules, there will no longer be any gap in tax periods when filing cessation tax returns.

We also noted some errors in some of the FIRS illustrations

Illustration 13

The due date of payment for the Company's 2021 YOA based on PYB should read 31 December 2020, as against 31 December 2021 as indicated in the circular. This is because the Company's financial year end is June 2020.

Illustration 14

The due date of payment for the Sole trader's 2021 YOA based on PYB should read 30 September 2020, as against 30 September 2021 as indicated in the circular. This is because the Enterprise's financial year end is June 2020.

Business reorganisation

The provisions of the relevant tax laws and the position in FIRS 2020/06 as explained in our earlier alert still remain the same. However, the FIRS' circular suggests that the consent or approval of the FIRS is not a condition precedent to enjoying the VAT and CGT concessions. Thus, VAT and CGT should not apply on the sale/transfer of assets in a business reorganisation to the extent that the relevant conditions are met. The circular indicates that approval from the FIRS is only required for the reorganisation waivers included in CITA.

Takeaway

The revision of the FIRS' position on the first basis period where a company's first accounts exceed 12 months, is a welcome development and is in line with CITA.

The changes to commencement and cessation rules introduced by the amendment to the PITA by the FA 2020 are sufficiently addressed by the Circular. However, an issue that persists is that companies and individuals that suffered double taxation on commencement under the old commencement rules (pre-FA 2019 and 2020) will not be compensated on cessation. It would have been more equitable to retain the old cessation rules for companies and individuals/enterprises that already commenced business and have suffered double tax.

As highlighted in our earlier Tax Alert, one of the anti-abuse conditions for businesses to obtain tax waivers on restructuring, is that the assets transferred should not be disposed of at least one year after the transaction. It would have been preferable for the FIRS circular to address whether this condition refers to all the assets, or whether the concession will be withdrawn if one or a portion of the assets are sold.

For a deeper discussion, please contact any member of our Tax Controversy and Dispute Resolution team below:

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