

FIRS Finance Act Circular

Business reorganisation, commencement and cessation rules

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Background

On 13 January 2020, the Finance Act 2019 (FA 2019) was signed into law. Some changes introduced by the FA 2019 include amendments to commencement and cessation rules, and business reorganisation.

The Federal Inland and Revenue Service (FIRS) has issued an information circular on these subjects. We highlight the key issues below.

Commencement and cessation rules

The FIRS clarified that:

1. A company 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 a company shall be from the date it commences business to the end of its first accounting year end date, irrespective of whether or not the company makes up its first accounts to that date. Where the first accounting period is longer than 12 months, the assessable profits for the first accounting period shall be ascertained on a pro-rata basis up to the indicated accounting year-end. Subsequent basis periods will be the 12-month after the previous accounting year end date.
3. A company that commenced business before the effective date of the FA 2019 may have a gap or an overlap of tax years when transiting from the old commencement 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 are to be filed 6 months after the cessation date.
5. Unlike under the old cessation rules, there will no longer be any gap in tax periods when filing cessation tax returns.

Business reorganisation

The FIRS clarified that:

The following concessions will apply to business reorganisations if the prescribed conditions are met:

1. Commencement and cessation rules will not apply.
2. Assets would be transferred at Tax Written Down Value (TWDV), i.e. there will be no balancing adjustments.
3. Capital Gains Tax (CGT) will not apply on the assets transferred.
4. Value Added Tax (VAT) will not apply on the assets transferred.

The following conditions must be met before the above concessions are granted:

1. The companies should obtain approval in writing from the FIRS.
2. The companies must justify to the FIRS that they have been related for at least one year before the transaction;
3. The transferred assets should not be disposed of at least one year after the transaction.

Where the assets are sold within this period, any concessions granted will be withdrawn by the FIRS, and penalties and interest will be charged from the transaction date.

Takeaway

The amendment introduced by the FA 2019 requires a company to render the returns for its first year of assessment from commencement to the end of its first "accounting period". Therefore, the position of the FIRS indicating 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" date is not supported by law.

For instance, if a company commenced business on 1st October 2019 and makes its first accounts to 31 December 2020, the first basis period should be the 16-month period from 1 October 2019 to 31

December 2020 in line with the FA 2019.

To request such a company to file returns for 4-months from 1 October 2019 to 31 December 2019 will be impracticable given that there will be no audited accounts and therefore no obligation to file returns within 6-months from that date, i.e. 30 June 2020.

Under the old rules, a company may be taxed twice during commencement due to overlapping periods. In principle, this "double-taxation" was compensated by the old rules, which creates a gap during cessation. Therefore, the new rules imply that companies that suffered the double taxation on commencement will not be compensated on cessation. It would have been more equitable to retain the old cessation rules for companies that already commenced business and have suffered double tax.

The reorganisation concessionary relief available to groups now clearly covers VAT and Capital Gains Tax (CGT) in addition to Companies Income Tax (CIT). One of the anti-abuse conditions is that the assets transferred should not be disposed of at least one year after the transaction. However, it is not clear if this refers to all the assets, or whether the concession will be withdrawn if one or some of the assets are disposed of. The condition also refers to a sale of assets, which means it should not apply to a sale of shares of the acquiring company within one year.

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