Critical issues arising from the requirement for non-resident companies to file actual tax returns in Nigeria

According to Albert Einstein, the hardest thing to understand in the world is income tax. This quote still resonates today and more so for non-resident companies who face a change in the practice of filing their tax returns in Nigeria.

The new directive which requires all non-resident companies to submit audited accounts and actual profit tax computations may create practical challenges. The old procedure was simple and straight forward, supporting two tenets of taxation – simplicity and certainty, as it was easy to impose tax on turnover without any need to worry about deductibility of expenses.

Overview

The Federal Inland Revenue Service ("FIRS") recently issued a directive based on Section 55 of the Companies Income Tax Act ("CITA") which requires non-residents carrying on business in Nigeria to file Nigerian tax returns with audited accounts and capital allowance computations. In practice, non-residents carrying on business in Nigeria were assessed to tax on a deemed profit basis of 6% of turnover (i.e. tax on a deemed profit of 20% of turnover at the corporate tax rate of 30%) prior to this directive.

Divergence of the tax law and company law

Nigerian legislation appears inconsistent on the treatment of non-residents carrying on business in Nigeria. Under section 54 of the Companies and Allied Matters Act ("CAMA") it is illegal for non-residents to carry on business in Nigeria without registering a subsidiary in Nigeria but CITA recognises the possibility of a non-resident company generating business income from Nigeria.

Failure to comply with the provisions of section 54 of CAMA makes all acts of the non-resident void and also liable to the penalties imposed by section 55 of CAMA. The practical approach adopted by most multinationals is to incorporate a subsidiary but still carry on business directly and execute projects in Nigeria.

The new directive which requires all non-resident companies to submit audited accounts and tax computations based on profits stated in those accounts may create practical challenges. The old procedure was simple and straight forward, supporting two tenets of taxation – simplicity and certainty, as it was easy to impose tax on turnover without any need to worry about deductibility of expenses. For non-resident companies it provided certainty, so the non-resident can predict its tax liability with certainty. In assessing the viability of projects, the non-resident company would simply incorporate 6% of revenue into their cost profile to determine if a contract is viable.

Determining the actual profits of a non-resident company (Nigerian branch) on the other hand, can be complex as they are not required by law to keep accounting records in Nigeria.

Legal and accounting challenges

Some of the legal and accounting questions arising from the directive (to address only a few) are: (1) What constitutes audited accounts for tax filing purposes? (2) Can the FIRS choose what basis of assessment it would accept? (3) How will a company treat an old asset for capital allowance purposes?

1. *What constitutes audited accounts for tax filing purposes?*

The general assumption is that the new directive to comply with Section 55 requires non-resident companies to submit audited financial statements. There are however some practical and legal issues to consider.

a. Practicality – It may be difficult or highly cost ineffective to determine the opening balances of assets and liabilities for the first year financial statements. This may result in qualified opinions by the auditors. The FIRS must be prepared for this and be practical in its approach.

b. What the laws says – It is important to make a distinction between the requirements for tax filing purposes and the provisions of CAMA. S.55 of CITA requires all companies (including non-residents) to submit "audited accounts". For a Nigerian company this requirement could be inferred to mean audited financial statements which will contain all the applicable statements specified under S.334 of CAMA (statement of accounting policies, balance sheet etc.) as modified by the Financial Reporting Council of Nigeria Act. However, there is no statutory framework in Nigeria under which the branch accounts of non-resident companies must be prepared. Therefore, audited accounts with limited information (for example that contains only statement of affairs and income statement) would not be in violation of S.55 as long as they are audited.

2. *Can the FIRS choose what basis of assessment it would accept?*

The FIRS stated that it reserves the right to still assess non-resident companies to tax based on turnover in accordance with S.30 of the CITA even if the company has complied with the filing requirements of s.55. However, a proper interpretation of s.30 may not support this position as shown below:

"if it appears to the Board (the FIRS) that a company's "trade or business produces either no assessable profits" or its "assessable profits … … are less than might be expected to arise from that trade or business", or "the true amount of the assessable profits of the company cannot be ascertained", to assess and charge that company for that year of assessment on such fair and reasonable percentage of the turnover of the trade or business…"

This should not be a discretion exercised arbitrarily to choose which option will generate more revenue to the detriment of the taxpayer. It should only be triggered where the specific criteria are applicable regardless of whether tax based on actual profit is more or less than deemed profit tax. This will ensure equity by treating a non-resident company like a Nigerian company.

Once audited accounts are submitted, together with actual tax computations, the onus will rest on the FIRS to prove that the conditions for actual tax filing have not been met.

3. *How will a company treat an old asset for capital allowance purposes?*

The FIRS has not provided any guidance on how capital allowances should be dealt with for old assets. Taxpayers are required to file their tax returns on self-assessment basis which implies that they could take a position on claiming capital allowances for old assets where the law has not specified one.

One key question is whether capital allowances can be deemed to have been claimed under the deemed profit tax regime or whether existing assets should be regarded as new additions for capital allowance purposes.

Conclusion

Overall, the new directive by the FIRS may lead to a situation whereby some non-resident companies with low margins are now able to carry on projects in Nigeria as they will be able to bear taxes that are proportional to their profit. This is on the assumption that any excess withholding tax suffered will be refunded by the FIRS otherwise there will be an implied minimum tax of 5% on turnover.

To ensure a smooth transition to the actual profit tax regime, the FIRS must issue guidelines on how the various items will be treated. In the meantime, affected taxpayers should engage with the FIRS to get clarity on the various grey areas which may be peculiar to them in time before the filing due dates.



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