

# ***Fiscal consolidation, inclusive growth and job creation***

## **Nigeria's 2012 Budget Speech**

*Tax and economic analyses*



## Introduction

On Tuesday 13 December 2011, the President of the Federal Republic of Nigeria presented the 2012 Federal Budget proposal to the joint session of the National Assembly under the theme ***“Fiscal consolidation, inclusive growth and job creation”***.

The budget for the coming year appears to address key sectors of the economy with specific fiscal and monetary policies for the actualisation of the goals. However, some of the goals which are probably well intentioned may not be realistic considering other related factors.

## Analysis of budget

Highlights	2012	2011	Change
Crude oil indices:			
- Price per barrel	\$70	\$75	-6.7%
- Daily production (mbpd)	2.48	2.30	7.8%
Revenue available for Federal Government (N billion)	3,644	3,343	9.0%
Expenditure profile (N billion)			
- Recurrent (non-debt)	2,472	2,423	2.0%
- Capital	1,320	1,148	15.0%
- Debt service	560	495	13.1%
- Statutory transfers	398	418	-4.8%
- Aggregate expenditure	4,749	4,484	5.9%
GDP Growth rate (budgeted)	7.20%	7%	2.9%
Inflation rate	9.50%	11.80%	-19.5%
US\$ Exchange rate	155	150	3.3%
Fiscal deficit (% of GDP)	2.77%	2.96%	-6.4%

## Crude oil indices

Reasonably, the government has used a prudent benchmark price of \$70 per barrel for the price of crude oil in the budget proposal considering the volatility experienced in the recent past.

While taking this into account, in generating its revenue which is projected to increase by 9%, the government would have to increase both oil and non-oil revenue. In this regard, the government has stated that there will be a strengthening of Nigeria's oil reserve base and increasing oil activities outside the traditional areas into the inland sedimentary basins.

Of particular importance is the interaction of this low or prudent benchmark price and its impact on the funding for the country's Sovereign Wealth Fund (“SWF”). If the price of crude is constantly above the \$70 mark, the excess will be transferred into the SWF for future savings, infrastructural development and economic stabilisation. This means the excess crude proceed will not be available for sharing to the 3 tiers of government. Before now, Nigeria was one of the few OPEC members without a SWF. However, after the formation of the Nigeria Sovereign Investment Authority (“NSIA”), Nigeria is now one of the countries that have made a conscious effort to secure the future through savings and investment. The NSIA will be split into the Nigeria Infrastructure Fund, the Future Generations Fund and the Stabilization Fund, according to the law enacted in May of 2011.

## ***Revenue generation for government expenditure***

In respect of non-oil revenue, the government has indicated that steps have been initiated to increase revenue by blocking leakages, improving corporate tax collection, and boosting internally generated revenue.

Apparently, this puts the Federal Inland Revenue Service (“FIRS”) under immense pressure to meet revenue targets by enforcing compliance and being innovative in protecting the country’s tax base. Transfer pricing will obviously be one of the ways by which the government intends to prevent revenue leakages going forward. Also, tax reforms such as providing incentives to key sectors and introducing provisions in the tax law to address loop holes appears to be a regular feature under the current administration.

## ***Recurrent expenditure (non-debt)***

Since the Central Bank of Nigeria (“CBN”) governor raised concerns about the level of recurrent expenditure, there has been increasing scrutiny from various stakeholders. In this regard, it is no longer business as usual as the president has obviously seen the need to curb some of the expenditures which have little or no long term positive impact. The inefficiencies identified by the president include corruption, waste and duplication, and high cost of governance among others.

## ***Debt service and capital expenditure***

Debt service expenditure and capital expenditure are expected to increase. The budget speech was not clear whether the increase in the amount of debt service by 13% was in order to manage the principal amounts borrowed or to make scheduled interest payments. If the latter, then it should be expected that the cost of debt service may continue to increase each year which will not address the increasing domestic debt profile of the country currently standing at about 16.4% of GDP.

Capital expenditure has been projected to increase by 15% to fund on-going projects to completion and to take on new projects under the government’s “Transformation Agenda”.

## ***Statutory transfers***

No reason was provided for the reduction in statutory transfers. This may be an issue for further review before the final passage of the 2012 Appropriation Bill.



## ***GDP growth rate***

The projected growth rate of 7.2% appears conservative given the potential for double digit growth and the necessity to achieve higher growth rate in order to actualize the Vision 20:2020 goal of becoming one of the top 20 economies in the world by the year 2020. The rising insecurity is perhaps one of the major challenges that the government needs to tackle urgently to ensure higher growth rate in the medium to long term.

Similarly, the government’s amnesty program has also been sufficiently successful in reducing the activities of militants in the Niger-Delta. The government must continue to monitor the amnesty program and ensure that the gains are sustained in order to achieve the projected growth rate in the 2012 budget proposal.

## ***Inflation rate***

The projected inflation rate of 9.5% tends to be overly optimistic considering the impact of several proposals that the government is currently pursuing. Particularly, the issue of the removal of fuel subsidy is likely to have a knock on effect on prices of goods and services in the short to medium term. Similarly, the proposed VAT Bill (which if passed into law would increase the VAT rate from 5% to 10%) would also make the inflation rate target difficult to achieve.

Other areas that may have an impact on the inflation rate include the proposed increase in import duty on certain goods (such as rice and wheat) to encourage local production and encourage “cassava bread”. Also, the devaluation in exchange rate would mean higher domestic prices given that the economy is largely import dependent.

We therefore expect that inflation rate would likely be higher than the 9.5% target except if the government can fast track some of the palliative projects including power generation, local refining and employment generation.

## **Exchange rate**

Many believe that the Naira is overvalued. The CBN was quick to react to a recent publication by the IMF suggesting that the government should devalue the Naira. Despite the counter arguments, the CBN eventually pegged the exchange rate at N155 to the Dollar (up from about N150).

Irrespective of what the actual position is, it is certain that the Naira is under pressure and hence the requests for Oil and Gas companies to use crude oil receipts to finance their foreign exchange needs rather than resort to the banking system to make payments for eligible transactions. In a related move the CBN in a recent publication by its Exchange and Trade department directed companies to source for foreign currencies in the ‘autonomous market’ for the purpose of remitting dividends, repatriation of capital and so on.

Such measures may stabilise the exchange rate at N155 in the official market but may lead to a much higher rate and margin in the autonomous market thereby encouraging round tripping.

## **Tax changes**

### **Corporate income tax**

There are no changes yet to the corporate income tax rate and the Companies Income Tax Act.

Some changes which would be gazetted very soon include:

- Introduction of policies to encourage the substitution of high quality cassava flour for wheat flour in bread-making. Bakeries have 18 months to make the transition and will enjoy 12% corporate tax rebate if they attain 40% blending.
- From 2012, concessions and waivers will be granted only on a sectoral basis. At this stage, it is not clear if this will have any impact on the existing pioneer tax holiday and other company specific incentives.

- Corporate tax waiver on all bonds and related instruments issued by corporate and governments – This proposal was made in 2010 and the reiteration of the president in his budget proposal indicates that the necessary legal framework will be put in place very soon.
- Regulations to support taxpayer’s self assessment
- Regulations to support companies involved in social projects and community developments including tax deductions for donations to companies involved in such activities
- Tax rebates for companies that create jobs

Other changes that have been proposed include:

- Fiscal policy measures will be introduced to encourage the purchase and utilization of locally produced commodities.
- Engagement of the Federal Government with key stakeholders to review the proposed Petroleum Industry Bill (“PIB”) with the intention of passing the revised version into law.

### **Personal income tax**

The Personal Income Tax (Amendment) Bill 2011 has been signed by the president according to the budget speech.

While we await the details of the Bill as enacted, we do not expect any major difference from the version passed by the National Assembly. Some of the key features are as follows:

- A consolidated tax free allowance of N200,000 or 1% of gross income whichever is higher plus 20% of the gross emolument
- Gross emolument is defined to include benefits in kind, gratuities superannuation and any other incomes derived solely by reason of employment
- Principal place of residence to include places where branch offices and operational site of companies are situated. Operational sites are defined in the bill to include oil terminals, oil platforms, flow stations, construction sites, etc with a minimum of 50 workers

- Revised graduated tax bands as shown below.

Bands	Proposed tax rates
First N300,000	7%
Next N300,000	11%
Next N500,000	15%
Next N500,000	19%
Next N1,600,000	21%
Above N3,200,000	24%

- Increase in minimum tax rate from 0.5% to 1% of gross income
- Individual tax clearance certificates (TCC) to be required for change of ownership of vehicles and application for land title transfer or perfection.

### **Indirect taxation**

There was no mention of the draft VAT Bill currently being developed by the FIRS. However, there are important proposals in relation to indirect taxes including:

- Review of the 2008 to 2012 Customs and Excise Tariffs to correct anomalies and introduce policies that will encourage industrialisation.
- Effective 31 January 2012, duty on machinery and specific equipment for use in the agricultural sector to attract zero import duty.
- All equipment for processing of high quality cassava flour and composite flour blending will enjoy a duty free regime. The government is in consultation with the sector to ensure effective transition.
- From 1 July 2012, wheat flour will attract import duty of 100%, wheat grain will attract import duty of 20%, brown rice will attract import duty of 30% and polished rice will attract import duty of 50%.
- Rice millers are encouraged to move towards domestic production and milling of rice. Import duty will thus be increased from 50% to 100% effective 31 December 2012.
- No waivers or concessions will be granted for rice and wheat production.
- Introduction of import prohibition for cassava flour.
- Equipment and machinery in the power sector will attract zero duty.
- The review of the Export Expansion Grant (“EEG”) to streamline the scheme and make it more effective as an instrument for promotion of exports.
- Review of Nigeria’s position on the ECOWAS Trade Liberalisation Scheme (“ETLS”) to avoid dumping.

### **Other important aspects of the speech**

#### **Power roadmap**

The president emphasized the government’s resolve to pursue the power sector reforms as the key structural reform under the current administration. In this regard, the objective of the president is to attract investors to the power sector similar to the telecommunications sector. There will be policies to encourage such investments in order to create jobs.

#### **Maritime and customs**

The budget proposal sets out the government’s intention to continue to pursue port and custom reforms. The Minister of Finance recently expelled certain agencies from Nigeria’s ports in order to reduce the cost and time required for the importation of goods into the country. The president has set up a committee to remove the bottlenecks at the ports and private sector users will monitor the implementation of these measures.

The government is also seeking to increase revenue generation from the maritime industry. We expect that there will be more focus on registration and compliance of vessels under the Nigerian Maritime Cabotage regime.

#### **Priority sectors**

Apart from the agricultural sector and bakeries, the government also identified some other key sectors including Information and Communication Sector, Solid Minerals Sector, Manufacturing sector, Aviation Sector, the creative industries etc.

In respect of the agricultural sector, the government intends to share risks with the Banks by guaranteeing 70% of all loans obtained to supply fertilizers and seeds. Similarly, the government intends to subsidise interest rates on such loans to bring the rate to not more than 7% per annum.

The above is in line with the recent mobilization of funds by the CBN to boost activity in the sector.



## Conclusion

The 2012 budget proposal appears to be the first step being taken by the federal government to drive some important policies. Some projections may not be very realistic but if we shoot for the sun, we may get to the clouds. In the end, Nigeria is a country that requires a government with tall visions, a great deal of decisiveness and political will to fully actualize the country's potentials and improve the standard of living of the people. All that is left is diligent implementation by the various arms of government which historically has been the major challenge. Whether 2012 will be any different, time will tell.



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