



Tax Alert* February 2009

Special Edition

In this special edition, we discuss the following topics:

- ✓ Paying Taxes – How does Nigeria fare on the global stage? Paying Taxes is a publication by the World Bank /IFC and PwC on the ease of paying taxes in 181 countries around the world including Nigeria
- ✓ Total Tax Contribution (TTC) – Most companies don't know how much tax they pay – do you? TTC is a PwC framework for reporting total tax paid to government analysed between taxes borne and taxes collected
- ✓ Tax Update – Proposed tax bills and tax changes

Happy reading!



2009 Paying Taxes Publication

Paying Taxes draws on three main criteria: Total Tax Rate; Number of Tax payments; and Number of Hours required to comply with taxes.

Only 6 countries in Africa are in the top 50 on the ease of paying taxes while 20 are in the bottom 50.

Nigeria ranks 39 in the world on Total tax Rate but 175 on Total Tax Time.

Time required to comply with employment income taxes is significant in Nigeria – about 378 hours per annum.

The latest edition of the *Paying Taxes* report, recently launched by the World Bank, IFC and PricewaterhouseCoopers, shows that tax authorities worldwide are overhauling tax systems by reducing taxes, streamlining administrative processes and modernising payment systems. *Paying Taxes 2009*, the third report in an annual series, is expected to prompt further dialogue between governments and businesses on improving tax systems.

The report draws on the *Doing Business 2009* report that measures the ease of paying taxes for mid-size domestic companies in 181 economies, analyses tax systems and tracks related reform efforts. It includes examples of how 18 economies have made use of data from the previous global *Doing Business* reports and provides insight into discussions with governments and other stakeholders generated by earlier *Paying Taxes* reports.

The impact of taxation on small companies is the focus of the report

The company that forms the basis of the case study is a simple domestic small enterprise, thereby ensuring that the focus of the results is purely on the local tax system as it impacts small and medium sized enterprises.

In arriving at an overall ranking on the ease of paying taxes the report looks at the following three indicators:

- i) the Total Tax Rate (the cost of all taxes borne by the company)**
- ii) the time taken to comply with the major taxes**
- iii) the number of tax payments for the major taxes**

The methodology used to calculate the first indicator, the Total Tax Rate, uses the broad principles from the PricewaterhouseCoopers Total Tax Contribution framework and looks across all taxes that businesses pay. The Total Tax Rate indicator measures the amount of all taxes borne by the business, expressed as a percentage of commercial profits.

Paying Taxes 2009 finds that in 2007/2008:

- Thirty-six economies made it easier to pay taxes.
- The most popular reforms were reducing corporate income tax rates (in 21 economies) and improving electronic filing and payments systems efficiency (in 12 economies).
- Eight economies reduced the number of taxes paid by business.
- On average, corporate income tax accounts for only 13 percent of tax payments, 26 percent of compliance time, and 37 percent of the total tax rate (tax cost to the case study company).
- Employment taxes account for 34 percent of the total tax rate, taking into account only amounts borne by the employer.
- On average, 36 percent of the overall time to comply with tax systems and 48 percent of the number of tax payments are spent on consumption taxes.

In Africa, taxes other than profit tax – such as stamp duties, property taxes and labour taxes – account for the largest share of the total tax rate. This is reflected in the large number of tax payments African businesses must make each year.

The report observes that around the world the continuing reduction in rates

The country where it is easiest to pay tax is Maldives with only one tax payment, one hour per annum to comply and 2% Total Tax Rate.

Mauritius, Botswana and South Africa occupy the top three positions on the ease of paying taxes in Africa

The most difficult country for paying taxes is Belarus with 180 tax payments, 179 hours per annum to comply and Total Tax Rate of 176% (total tax borne as a percentage of commercial profit).

of corporate income tax suggests a shift from taxes on profit to taxes on consumption and Value Added Tax ("VAT") is the most common form of consumption tax that economies are implementing, with 79 per cent of economies now using VAT in one form or other.

The report makes clear that corporate income tax reform has had a positive impact for government and business in a number of economies, yet these benefits could be multiplied if tax reform is looked at in its entirety. Tax reform should include all business taxes - not just corporate income tax. It should include all administrative aspects and the relationships between government and business generally.

The report notes that economies that rank highly on ease of paying taxes tend to have lower and less complex taxes with simple administrative processes for paying taxes and filing tax returns

Matters of specific relevance to Nigeria

- **Nigeria's ranking in this latest report in** terms of ease of paying taxes is 120 out of the 181 economies surveyed. Overall, within Africa Nigeria came in "mid-table" at 28th out of the 51 African countries covered. The best performing African economies were Mauritius followed by Botswana then South Africa. In terms of the West Africa Community ("WAC"), Nigeria's overall ranking was worse than Liberia, Ghana, Cape Verde and Guinea-Bissau (ranked 59, 65, 115 and 117 respectively) but better than Burkina Faso, Togo, Cote d'Ivoire, Mali, Sierra Leone, Benin, Guinea, Senegal, Mauritania and The Gambia.
- **The report finds that necessary steps have been taken in Nigeria to ensure effective and efficient tax administration.** The Federal Inland Revenue Service Establishment Act was enacted in 2007 and this has empowered the tax authority in Nigeria to make

certain decisions and take steps that have led to the reduction of the number of hours for paying taxes and quicker dispensation of tax disputes. Physical contact with tax officials has been reduced by the tax authorities encouraging online processing of tax applications and tax payment receipts.

- **Corporate income tax reduction is the most popular reform.** For example, in Africa the report notes that 2007 / 2008 has seen the corporate income tax rate reduce to 25% in Cote d'Ivoire and Madagascar – a step that Ghana took in 2006 – and that Nigeria's proposed tax reforms contemplate an even larger reduction from 30% to 20%. A challenge posed for the wider West Africa region is to consider implementing such a reform – perhaps with a reduction in the current common corporate income tax rate of 30% to 25%. The report notes that tax revenues in Mauritius and Russia actually increased following reductions in tax rates.

The report points out that where taxes are high and commensurate gains (in terms of services received in return) are low, many businesses simply choose to stay informal. It makes reference to a recent study that found that higher tax rates are associated with less private investment, fewer formal businesses per capita and lower rates of business entry – with the analysis suggesting that a 10 per cent increase in the effective corporate tax rate reduces the investment-to-GDP ratio by 2 percentage points. Certainly, many countries are easing the complexity of their tax system and reducing the tax burden for businesses. Indeed, since 2004, average total tax rates have been reduced by 3 percent and time to comply with taxes decreased by 5 percent. This reform effort can broaden the tax base and increase tax revenues.

The report also includes a chapter setting out the PricewaterhouseCoopers perspective on what makes a good tax system listing 20 suggested hallmarks.

For information about *Paying Taxes*, or to download a copy of the report, do visit www.doingbusiness.org/taxes.

Total Tax Contribution

Do you know the total tax contribution your business makes to governments?

How much of your taxes paid is borne by your company or just collected for the government?

Total Tax Contribution is the total of all business taxes paid by a company either in a particular country or on a global basis

In a recent survey carried out by PwC on behalf of The Hundred Group of top companies in the UK, many executives were shocked to discover the total taxes paid by their companies and time consumed collecting taxes on behalf of government. These results have led to executives reassessing the importance of understanding the true cost of taxation to their business and improving the effectiveness of their tax functions.

The PricewaterhouseCoopers Total Tax Contribution ('TTC') framework

The PricewaterhouseCoopers Total Tax Contribution framework was developed with a view to establishing a methodology which enables companies to collect and communicate total tax information in a consistent manner, meeting the needs of their various stakeholders and helping to improve transparency.

The framework encompasses all the taxes that are paid by companies and includes, for example, property taxes, labour taxes and contributions, sales taxes and other taxes, as well as corporate income tax. It makes a fundamental distinction between two types of taxes paid by companies: these are known as 'taxes borne' and 'taxes collected'. In essence, taxes borne are those

which are a cost to the company, such as property taxes, irrecoverable withholding tax and VAT, employer social security and corporate income tax. Taxes collected are where the company is collecting the tax on behalf of the authority, including taxes deducted from employees' salaries, sales taxes and excise duties. The TTC framework also includes the cost of tax compliance.

In order to fully understand the TTC framework, it is important to first understand what a tax is.

What is a tax?

In the context of the PricewaterhouseCoopers Total Tax Contribution framework, the question of defining what is a tax has been an important one to answer to ensure a solid base for comparison and analysis. Tax under the TTC includes government mandated contributions, even though they may not fit the traditional definition of tax.

As a starting point, a tax can be defined as something which is:

- paid to government
- compulsory
- used by the authority as part of the public finances
- with no direct return of value to the payer



Payments in respect of labour

Payments in respect of labour, such as payroll taxes and social security contributions, can

constitute a significant part of tax cost (where they are borne by the employer) and the compliance burden (where they are collected from the employee). Such payments are included in the TTC where they meet the definition of a tax, notwithstanding that they may be governed by

Total Tax Contribution is much wider than just corporate income tax

TTC makes a distinction between taxes which are a cost to the company and taxes which the company only collects

separate legislation or called a contribution rather than a tax.

Companies in many economies are required to pay to government forms of social security or other taxes connected with employing their workers. In most cases, these payments are compulsory and used by the government as part of public finances – they are not, for example, used for the direct benefit of the employees of the company and therefore do not provide any direct return of value to the company or the employee. These payments can be properly included as a tax. However, unless all of the necessary requirements listed above are met then treatment as a tax may not be appropriate.

A specific illustration of this point, is the pension contribution in Nigeria. This is a mandatory contribution of at least 7.5% of an employee's salary (Basic + Housing + Transport). While it is compulsory, it is paid into a separate retirement savings account which is specifically allocated for the benefit of each employee. As such, under the PricewaterhouseCoopers methodology it is accepted that this payment is not a tax as it is an employee benefit, not a general payment into public finances.

Taxes borne and taxes collected

As mentioned above, the PricewaterhouseCoopers Total Tax Contribution framework makes a fundamental distinction between taxes borne and taxes collected. The split is important for the purpose of understanding the impact of taxes on the company and for analysis of the TTC results. Taxes collected are important, as they contribute to the number of hours that the company takes to comply with the tax system and they also impact on the number of tax payments. They therefore contribute significantly to the administrative cost of the tax system and to the effort and resource required.

A common definition of the terms is as follows:

Taxes borne – those which are paid by the company and are a cost to the company.

Taxes collected – those for which the company acts as tax collector or administrator for the tax authority. Taxes borne could also be termed 'taxes suffered', in that these are the levies that really do impact the company concerned. It does not matter whether the charge to the profit and loss account is direct (for example the corporate profits tax charge) or indirect (such as duties and VAT paid on the purchase of assets, which are capitalised as part of the assets' cost and then depreciated over a period).

Both the corporate income tax and the duties and VAT would count as taxes borne. For the duties and VAT, the amount borne would be the full amount paid in the period rather than the amount amortised.

Taxes borne are a cost to the company and, as for other costs, will ultimately be passed on, for example in higher prices to customers, lower wages to employees or lower dividends to shareholders. This ultimate incidence does not affect the treatment under TTC as a tax borne.

Taxes collected are those where the company acts, in effect, as (unpaid) tax collector on behalf of the tax authority. The classic examples are sales/VAT and excise taxes, together with taxes and contributions deducted from employees' pay (such as PAYE tax). The only impact taxes collected have on the company's profits will be via administrative costs.

Importance of the Total Tax Contribution framework

The tax environment is changing due to the following:

- Tax has risen up the corporate risk agenda
- Governments are under pressure to protect their tax revenues

Total Tax Contribution includes the cost of complying with the tax system

Tax compliance cost is an indication of complexity of the tax system and the regulatory burden, the lower the cost the better for both the taxpayer and the government

TTC provides useful information for external communications and corporate responsibility reporting

- There are concerns about the competitiveness of the tax system for investment
- Many stakeholders are now interested in tax more than ever before
- Links are being made between tax and corporate responsibility

- Individual companies, to help them measure and understand the overall tax burden and what they contribute to the public finances;
- Business groups and Trade Associations to establish the position for specific sectors; and

Government and government organisations, to help them understand the impact of the tax system in order to develop appropriate policies and improve tax administration.

Upcoming Projects

At PwC Nigeria, we plan to do TTC projects with:



Tax Update – Current & Proposed Changes

Government to introduce compulsory CSR - The federal government has initiated a bill, which if passed into law, will mandate every company in Nigeria to spend not less than 3.5% of their gross annual profits on CSR.

Energy Tax – A bill for the introduction of Energy Development Tax which will require every company registered in Nigeria to pay 2% of their assessable profits has been proposed by the National Assembly.

Police Tax – A bill to introduce a Police Tax, which shall be at the rate of 2 per cent, chargeable on the assessable profit of a company registered in Nigeria. The bill was introduced in 2004.

FCT introduces property tax in Abuja - the FCT Administration is working on a bill for the introduction of property tax in the FCT with effect from 2009.

National Health Insurance Scheme (NHIS) – there is a proposal to make NHIS contribution compulsory. Currently the scheme is voluntary for

the organised private sector.

Enforcement of IT Tax – The FIRS has started implementation and enforcement of IT tax based on the NITDA which came into effect from 2007. The Act requires specified companies to pay 1% of PBT as IT tax.

Lagos State amends deemed income for expatriates - Based on the schedule as provided by the Nigeria Employers' Consultative Association, the new deemed income has increased by up to 300%. The lowest deemed income is now ₦4m for technicians and low level management in private manufacturing and trading companies. The highest is ₦140m for executives of oil producing companies.

Govt goes after tax evaders, sets up special tribunals - the Federal Government is to inaugurate special tribunals to try tax evaders and address complaints from tax payers.

Excise duty – government to remove the recently imposed 5% excise duty on non-alcoholic products.

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Contacts: Ken Aitken – Head of Tax
Russell Eastaugh – Tax Director
Taiwo Oyedele – Senior Tax Manager

PricewaterhouseCoopers
252E Muri Okunola Street, Victoria Island, Lagos, Nigeria
Tel: [+234] (1) 2711700, 2703101
Fax: [+234] (1) 2703109
www.pwc.com/ng