Matters arising from government's review of pioneer status incentive: Is the holiday over?

All may not be rosy for many companies that are currently enjoying, or have recently enjoyed tax holiday status under the pioneer tax regime. This is on the heels of the Federal Government's recent move to review the existing tax incentive regime, especially pioneer status.

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Overview

The Pioneer Status incentive grants companies carrying out certain approved activities a tax holiday period from Companies Income Tax (CIT) of up to 5 years. The law and regulations backing the regime are the Industrial Development (Income Tax Relief) Act (IDITRA) of 1971 and the Pioneer Status Incentive Regulations, 2014. The agency that regulates the incentive is the Nigerian Investment Promotion Commission (NIPC).

The aim of the incentive is to encourage investment in certain industries not already carried on in the country or where the existing industry is not operating at a level that is sufficient to meet the nation's needs. This includes activities which the government considers to be of importance to the Nigerian economy.

The policy motive of pioneer exemption is to encourage the growth of nascent (hence the term "pioneer") businesses and start-ups, especially those involved in local raw material development and labour intensive processing. The NIPC is empowered to publish a list of these approved activities and update the list when necessary. A company that meets the qualifying criteria is issued a "pioneer certificate" by the NIPC, which states the trade/business that is covered by the exemption.

The pioneer holiday is granted for a period of 3 years in the first instance, after which it can be renewed up to 2 additional years. However, in some cases, the NIPC had gone ahead to issue pioneer certificates for the full 5 years all at once.

The tax incentives

Apart from the income tax holiday, other key benefits of the pioneer exemption are:

- Deduction of fixed asset costs after tax holiday - Fixed assets acquired during the tax holiday period are considered to have been bought post pioneer. This allows companies get full tax deduction for the cost of these assets after the tax holidays including investment allowance where applicable.

- Tax losses – Tax losses incurred during the tax holiday can be used as set off against taxable profits earned after the tax holiday.

- Tax free dividend – Dividends paid out of pioneer profits are tax exempt whether paid during pioneer or post pioneer period.

These incentives explain why many companies are keen to obtain pioneer status.

Is the regime meeting its objectives?

Due to the obvious appeal of the pioneer incentives for companies, the NIPC has been inundated with an increasing number of applications for the incentive. The government's drive to make Nigeria an investment destination for different kinds of businesses led to the expansion of the list of eligible pioneer trades. This was increased from about 37 in 1982 to currently over 70 products/industries.

Questions have been asked as to whether the pioneer tax incentive is meeting its intended objectives, and whether some companies that obtained the incentive under the expanded list indeed qualify for the incentive. The Federal Inland Revenue Service (FIRS) for its part had also taken a critical stance, hence the mixed messages from different stakeholders created some degree of uncertainty for those concerned.

Policy review on pioneer tax holiday

In the past few months however, the reduced petroleum revenue accruing to the government as a result of the dwindling oil prices, has led to the focus on alternative sources of income, particularly taxation. Following this, the federal government has initiated a process to review existing incentive regimes, especially the pioneer status.

As part of the review, the top management of the NIPC has been replaced, and all new applications for pioneer status have been put on hold pending the outcome of the exercise. The NIPC also organised a series of stakeholder meetings towards the end of 2014, and one of the key objectives of these meetings was to provide policy clarifications on investment related issues including pioneer status.

The NIPC has now issued letters to some companies that were granted the incentive for 5-years informing them that the holiday should have been for an initial period of 3 years, in line with the IDITRA. The FIRS has consequently raised assessments on some of these companies for the last 2 years of their 5-year pioneer status. It is not yet clear if these assessments will be extended to all companies that were granted the 5-year pioneer status or if there is some targeting of specific companies or industries involved.

Legitimate expectation

A strict interpretation of the IDITRA may support this move by the NIPC and the FIRS. However, companies that are legally entitled to the incentive have a tenable argument based on the doctrine of legitimate expectation. This doctrine applies the principles of fairness and reasonableness to situations where a party has an expectation or interest in a public body retaining a long-standing practice or keeping a promise. A legal or reasonable expectation arises on the existence of such regular practice which can reasonably be expected to continue. Once legitimate expectation exists, it effectively amounts to a contract and going back upon it is a breach.

In many cases, the one-off tax holiday of 5 years was not solicited by companies, and was issued by the NIPC (most likely) for administrative convenience. In fact, the Pioneer Incentive Regulations, 2014 introduced a charge of 2% on projected savings as a requirement for getting pioneer exemption, and this charge was computed based on the 5-year financial projections.

Issuing assessments to companies for the last 2 years of their 5-year pioneer status granted by the NIPC appears to be a breach of a legitimate expectation. This is especially so as the 5 year exemption had not been contested or objected to by the FIRS in the past.

Some FIRS officials take the position that in fact, the responsibility to approve the 2 year extension rests with the FIRS, and section 10(4) of the IDITRA has been cited as a basis for this. This section provides that:

"A pioneer company wishing to obtain a certificate (for extension)… shall make an application in writing to the Board (FIRS)…"

This position however does not hold up so well when closely examined because when the provision is read in its entirety, it is clear that the approval to be given by the FIRS for the certification of capital expenditure incurred to qualify for the extension, in respect of which the company can get tax deductions through capital allowances after the tax holiday.

This move by the Federal Government however brings a number of questions to mind. First, if the NIPC can go back to repudiate the remaining 2 years of the 5-year tax holiday initially granted to companies, is there a mechanism for the affected companies to retrospectively apply for and obtain extension for the 2-year periods? To the extent that these companies would have met the criteria for extension it is only equitable to allow for retrospective approval, as the reversal itself is ex post facto.

Conclusion

These are tough times and hence the tough measures by government. Companies should therefore be wary of incentives (and favourable tax rulings, etc) which they may have previously obtained based on practice rather than the law, as they can be reversed at any time.

For now, the FIRS appears resolute on this move. Affected companies must find amicable ways to resolve the issue and where necessary be willing to challenge the partial withdrawal through the courts.

From a tax policy point of view, this move underlines the importance of a harmonised policy thrust by government with respect to taxation. There should be a constant monitoring of all tax incentives to ensure effectiveness and prevent abuse. A situation where tax incentives are reversed after being honoured by tax authorities in the past creates uncertainty, and may even discourage investment.

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