Nigerian companies are now liable to income tax at 60%

That is if the new judgement of the Tax Appeal Tribunal on excess dividend tax is sustained.

As a lasting solution, the National Assembly should amend the law to make it clear that Section 19 is not applicable to profits which have already been taxed and those that are specifically exempted from tax.

In Brief

This may be ridiculous but it is true! At a time when many countries are reducing their tax rates to attract and retain investments, Nigeria seems to be moving in the opposite direction.

On 18 July 2014 the Tax Appeal Tribunal in a case between Oando Plc and the Federal Inland Revenue Service (FIRS) ruled in favour of the FIRS. The decision was based on the Tribunal's interpretation of Section 19 of the Companies Income Tax Act as applicable to dividend distribution. The decision creates more uncertainty on the issue of "excess dividends" tax as the Tribunal did not follow an earlier decision of the Federal High Court between the same parties and on almost identical facts.

In Detail

Background

Section 19 of the Companies Income Tax Act (CITA) imposes what is generally known as excess dividends tax. It provides that, where a dividend is paid out of profit on which no tax is payable due to no total (that is, taxable) profits; or taxable profits which are less than the amount of dividend paid …, the company paying the dividend shall be charged to tax at 30% as if the dividend is the taxable profits of the company for the year of assessment to which the accounts, out of which the dividend declared, relates.

In essence, under Section 19 any dividend paid in the instances set out in the section will be treated as taxable profits subject to tax at the rate of 30%. If applied without measure, this invariably means an effective corporate income tax rate of 60% where previously taxed retained earnings are distributed, and at least 30% in all other cases including exempt income and gains taxable exclusively under the Capital Gains Tax legislation.

Facts of the case

The Appellant (Oando) declared and paid dividends to its shareholders in the years 2005, 2006 and 2007. The FIRS, relying on Section 19 of CITA, assessed the dividends to tax at the rate of 30% on the basis that the dividends exceed the company's taxable profits for the respective years. Oando objected to the assessment but the FIRS subsequently issued a notice of refusal to amend the assessments upon which the company lodged the appeal.

Overview of judgment

Oando's position

Oando put forward three major arguments. First, the dividends were paid out of retained earnings which had already been taxed in prior years. Secondly, FIRS should have considered and applied Section 80 of CITA which exempts dividend income that has been subjected to withholding tax from further tax. This is relevant given that the company earns dividend income from its subsidiaries. Third, if Section 19 is considered ambiguous then it should be interpreted in favour of the taxpayer in line with the contra fiscum rule.

FIRS' position

In its defence, the FIRS appeared to agree that dividends paid from retained earnings should not be subjected to excess dividends tax. It submitted that Oando had not satisfactorily convinced the FIRS that tax had been paid on the retained earnings out of which the dividends were paid. It also argued that the provisions of Section 19 were clear and unambiguous therefore they should be given their literal interpretation.

The decision

The Tribunal, in interpreting Section 19, held that dividends paid from retained earnings, where there is no taxable profit or taxable profit is less than the dividends, should be taxed at 30% regardless of whether the earnings had been taxed previously. The Tribunal outlined four steps to be followed before subjecting a company to tax under Section 19.

According to the Tribunal, the first step was to ascertain why no tax was payable – which could either be due to no taxable profits or taxable profits less than dividend paid. The second step is to regard any such dividends paid as the taxable profits of the company. Thirdly, the actual taxable profit for the current year should be deducted from the dividend (deemed taxable profit) to determine the excess. The final step is to apply the tax rate of 30% to the excess established under step 3.

The Tribunal held that since the FIRS had complied with all the four steps Oando was rightly assessed to the additional tax. The Tribunal appears not to have considered the 2008 decision of the Federal High Court (FHC) between the same parties on similar facts. In that case the import of the FHC decision was that dividends paid from retained earnings were not subject to excess dividends tax because such retained earnings would have already been taxed in prior years.

The takeaway

Before this decision, many companies had relied on the sentiment expressed in the FHC decision of 2008 in establishing that their dividends in excess of taxable profits were paid from retained earnings and should not be taxed twice. This judgement by the Tribunal serves to question this position.

The Tribunal's decision also raised a couple of fundamental questions –

1. Why would the law seek to impose double taxation on companies for delaying their dividend distribution or simply reinvesting their profits?

2. Why did the Tribunal not apply the doctrine of judicial precedent by following the earlier decision of the FHC?

Although we understand that this judgement has been appealed, it may be prudent for companies seeking to pay dividends out of their retained earnings to ensure that such dividends do not exceed their taxable profits for the relevant year pending the resolution of this dispute.

As a lasting solution, the National Assembly should amend the law to make it clear that Section 19 is not applicable to profits which have already been taxed and those that are specifically exempted from tax.

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