July 2012

Tax Alert

Tax waiver on all bonds and short term government securities

More to enjoy tax deductible donations

pwc

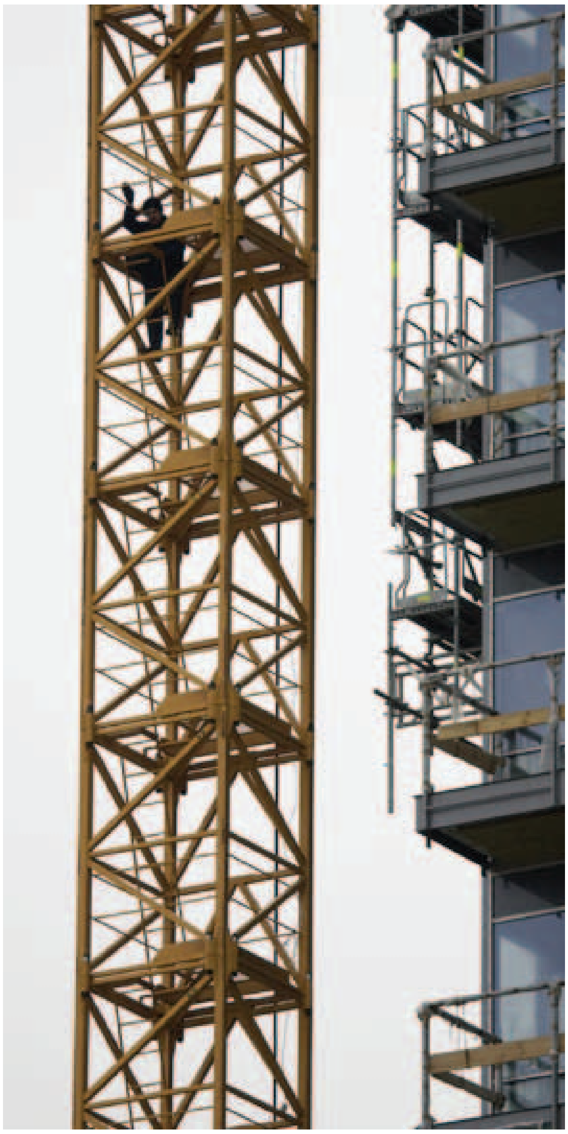
www.pwc.com/ng

More to enjoy tax deductible donations

Background

The Minister of Finance recently modified the Fifth Schedule to the Companies Income Tax Act effective from 12 December 2011. In addition to the existing bodies eligible for tax deductible donations listed in the Act, more institutions, bodies or funds engaged in the following broad categories of activities are to enjoy tax deductible donations provided such organisations are not set up for the purpose of profits or gains to the individual members of the society, association or person.

- Promotion or defence of human rights
- Women empowerment and development
- Re-orientation, rehabilitation, welfare support service for orphans, widows, physically challenged, refugees and all categories of persons that may require social or economic rehabilitation and transformation
- Youth empowerment and development
- Leadership and Resource Development
- Promotion of National Unity and Patriotism
- Promotion of Social and Economic Development
- Accident prevention and control activities
- Information system development and awareness
- Creation of awareness for transparency in governance and electoral processes
- Promotion of national unity and patriotism
- Museum development and promotion of sports, arts and culture
- Rendering assistance in the provision of safe water, electricity, infrastructure and agricultural development
- 14.Any professional body established under an Act of the National Assembly for the regulation and practice of the profession.



Further developments

In an extraordinary gazette recently published as a supplement to the Fifth Schedule amendment, the FIRS will have to certify the approved bodies. This requirement is effective from 12 December 2011 and therefore any tax deductions taken for donations after this date could be disallowed by the FIRS if the necessary certification has not been obtained.

Although the requirements for the FIRS to certify approved bodies for deductible donation has some merits, if not properly implemented it could lead to selective treatment thereby defeating the National Tax Policy objective of applying incentives to industries rather than individual organisations. This may also contradict the policy of the government to grant broad based tax incentives in a transparent manner without preferential treatments to specific companies and individuals.

if not properly implemented it could lead to selective treatment

Key provisions of the supplementary gazette

Requirement to qualify as a 5th Schedule fund, body or institution

- The entity must be of a public character;
- Activities must benefit Nigerians in general;
- Its profits must not be available for distribution to promoters;
- Promoters and Board of Trustees or governing body must be in compliance with tax laws;
- Other specific requirements under the schedule are to be completed in an application to the FIRS.

Certification

- Applicants are to pay a processing fee to be communicated;
- Completion of an application form issued by the FIRS;
- Approval is to be granted by the Board of the FIRS within 30 days of receiving the application and communicated to the Minister of Finance.

A certificate issued to any successful body will be valid only for 3 years subject to renewal every 3 years upon satisfactory performance and compliance with relevant legislation. Approved bodies are also required to file annual returns in line with relevant tax laws and submit a compliance report annually stating the activities of the body; and including a statement of affairs and auditor’s report.

Tax waiver on all bonds and short term government securities

Background

In March 2010, the Federal Government through the Debt Management Office announced the approval by the Federal Government of a tax waiver for all categories of bonds (including corporate bonds) and short term government securities such as treasury bills. The announcement also included a reduction in stamp duties for re-issue of previously executed debentures to 20% of the stamp duty payable on a new debenture.

The declaration made in 2010 was at best a statement of intention subject to administrative and legislative processes required to give the necessary legal backing.

Furthermore, the President in the 2012 Budget Speech delivered to the National Assembly in December 2011 again stated government's intention to grant tax waivers on all bonds and debt instruments issued by all tiers of government and corporate entities.

Subsequently, the Personal Income Tax Amendment Act 2011 ("PITA Amendment") was gazetted in January 2012 but effective from 14 July 2011. The PITA Amendment provided the required legal backing to the waiver for persons (essentially individuals) liable to tax under PITA only. To ensure that all investors benefit from the incentive regardless of their legal status, the President and the Minister for Finance have issued a Companies Income Tax Exemption Order and a Value Added Tax (Modification) Order respectively. The Orders which were recently gazetted both have commencement dates of 2 January 2012 to exempt income and proceeds from the disposal of debt securities from income tax and VAT.

We analyse below the key issues in relation to the Orders and the new tax waivers.

Before the PITA Amendment and CITA gazette

The Local Loans (Registered Stock and Securities) Act of 1946 (as amended) empowers the Minister of Finance to issue bonds specifying the notional amounts, coupon rates, maturity dates and also specify the tax exemptions to be accorded such bonds.

The exemption granted by the Local Loans Act does not cover most debt securities such as Treasury Bills and state government bonds. Corporate bonds were also taxable. However, Section 30 of the Capital Gains Tax Act LFN 2004 provides exemption from capital gains tax ("CGT") for the disposal of Nigerian Government securities (including Federal, State and Local government bonds), stocks and shares. Although the scope of the CGT exemption is wide, it did not provide sufficient comfort as it was only useful where the income was considered capital rather than revenue in nature.

The impact of the PITA Amendment

The PITA Amendment effective from 14 July 2011 exempts the following from personal income tax:

- Bonds issued by Federal, State and Local governments and their agencies;
- Bonds issued by corporate and supra-nationals (including organisations like the world bank, IFC etc); and
- Interest earned by holders of the bonds, and short term securities listed above.

Impact of the CITA gazette

The CITA gazette grants exemption to companies on their trading income from corporate and government bonds, treasury bills and other short term securities. In this regard, there should be no withholding tax although this is not specifically stated but can be inferred given that withholding tax is an advance payment of income tax except where it is deemed to be a final tax.

Impact of VAT gazette

Previously, proceeds from disposal of debt instruments have not been subject to VAT in practice. The basis for this is that the Nigeria's VAT law imposes VAT on the supply of goods and services and this may not be extended to such instruments as they are neither goods nor services. In addition to this, the Federal Inland Revenue Service ("FIRS") also issued Information Circular No. 9503 in 1995 where they took the position that capital and returns on capital should not be subject to VAT.

The VAT gazette could therefore have far reaching implications if it is interpreted to mean that VAT was previously applicable, if not, a specific tax exemption would not have been required. Also, at the expiration of the 10-year VAT exemption period, there is a high possibility that the tax authorities will seek to impose VAT on disposal of bonds and T-bills. The newly published VAT exemption Order will only become relevant if the new VAT law currently being drafted for consideration by the National Assembly which seeks to VAT such transactions is enacted into law.

Comments and conclusions

Period covered

Apart from the clear exemption for T-bills under the CITA gazette which was not specified in the PITA gazette, one key area of difference between the PITA Amendment and the CITA gazette regarding the tax exemption on bonds is that the PITA exemption is not time-bound unlike the CITA exemption which is only for 10 years.

It is not clear if the commencement date refers to year of assessment or the basis period. It is also uncertain whether the exemption will only apply to instruments issued after the commencement date or whether it will apply to all income accruing after the period including those on instruments issued prior to the exemption. In our view, the exemption period should be with reference to basis period and should cover all income accruing to investors effective from the commencement date regardless of when the

instrument was issued. There is therefore a need to track the flow of income from relevant securities and exclude income earned during the exemption period from tax. This should include exemption from withholding tax deduction. However, by implication, any expense incurred in earning the exempt income may not be tax deductible.

Excess dividend tax

By these exemptions, issuers and investors are likely to seek and accept a lower coupon rate than they would without the tax exemption. However, the exemption may create a situation whereby the income earned may be taxed in the company upon redistribution in the form of dividend.

This is due to potential excess dividend tax exposure at 30% as a result of having more distributable profit than taxable profit. Where this happens it will nullify the effect of the exemption thereby leading to possible mispricing of the debt instrument.

In our view, it is clearly against the principles of a good tax system to grant a tax waiver with one hand and then subject the income to tax on another hand.

Conclusion

Overall, the tax waiver will reduce the tax burden for investors especially individuals but corporate investors need to consider the real tax cost and effective tax rate of their investments in bonds and other debt securities in view of the potential excess dividend tax exposure and non deductibility of related cost of investment. Without this, such investors are likely to misprice their investment and therefore be worse off under the exemption regime.

www.pwc.com/ng

PwC is a global market leader for tax services. We assist businesses, individuals and organisations with tax strategy, planning, and compliance, whilst also delivering a wide range of business advisory services with 23,000 dedicated tax professionals in over 140 countries. This means that we can support you both locally and globally, wherever you require our services.

According to Global Tax Monitor PwC is the leading provider of tax services worldwide. Our reputation as global market leader extends to the various tax service areas, where we have a very strong lead over the competition in domestic and cross-border tax compliance, domestic and international corporate tax planning, indirect tax/VAT, M&A, transfer pricing, compensation & benefits, tax risk minimisation, tax accounting, tax function effectiveness and expatriate tax planning and compliance.

Contacts:

Kenneth Aitken, Head of Tax (ken.aitken@ng.pwc.com)
Russell Eastaugh, Tax Director (russell.eastaugh@ng.pwc.com)
Taiwo Oyedele, Tax Partner/Director (taiwo.oyedele@ng.pwc.com)
Emuesiri Agbeyi (emuesiri.agbeyi@ng.pwc.com)

Contributors:

Kenneth Erikume (Kenneth.y.Erikume@ng.pwc.com)
Emeka Amadi
Augustine Ogun

Address:

PwC, 252E Muri Okunola Street, Victoria Island, Lagos.