The importance of Certificates of Acceptance for tax and financial reporting purposes

For companies that employ significant non-current assets in their operations, the ability to obtain capital allowances as a 'tax shield' against profits earned is very important. On the other hand, the tax authorities would be inclined to disallow such capital allowance claims where appropriate third party documentation and acceptance certificates are not available.

By Seun Ajayi

Recently, the Industrial Inspectorate Department (IID) of the Federal Ministry of Industry, Trade and Investment (FMITI) started issuing letters to companies to remind them of their compliance obligation to file annual returns of capital expenditure and obtain the necessary approvals. But what is all this about and how is the Federal Inland Revenue Service (FIRS) or the Financial Reporting Council of Nigeria (FRCN) connected with the issue?

Background

The Industrial Inspectorate Act (IIA) empowers the IID to carry out investigations into any proposed, new and existing undertaking involving capital expenditure, and in particular, for the purposes of determining the value of such investment.

This implies that companies proposing to start a new undertaking or incur additional capital expenditure in respect of an existing undertaking must notify the IID of its intention to incur capital expenditure. The IID will then verify and if satisfied, issue a Certificate of Acceptance of Fixed Assets (CAFA) certifying the value of the capital expenditure. The approval is applicable to any asset that individually costs NGN500,000 or more.

The FIRS connection

The FIRS is charged with the administration of the Companies Income Tax Act (CITA), which is the legal basis for the imposition of tax on the income of companies in Nigeria.

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In computing income tax, a company is granted capital allowances in lieu of depreciation. This serves to reduce the company's taxable profit and ultimately its total tax payable.

For companies that rely heavily on assets for the generation of profits, the ability to obtain capital allowances and investment allowance as a 'tax shield' against profits earned is very important. On the other hand, the tax authorities would be inclined to disallow such capital allowance claims where appropriate third party documentation and acceptance certificates are not available.

There could be disputes regarding the value of assets for various regulatory purposes. However, Section 5 of the IIA provides a cover for companies once they have obtained asset certification by the IID. The FIRS and other agencies (such as the Nigerian Customs Services) are obliged to rely on the IID certification of value in any matter relating to the determination of cost incurred to acquire such assets.

Failure to obtain CAFA could therefore result in the FIRS disallowing any capital allowance claimed by a company in respect of the assets on the basis that the company has failed to comply with the law. Historically, the FIRS followed this approach in practice to disallow capital allowance claims by a company if there was no evidence of CAFA to support the related Qualifying Capital Expenditure. Recent events suggest that the FIRS has been exploring new ways to generate more revenue and may look at areas where companies are not compliant with existing laws.

The FRCN connection

The FRCN was established by the FRC Act and coincidentally is also a parastatal under the supervision of the Federal Ministry of Industry, Trade and Investment (like the IID). The FRCN is tasked with ensuring accuracy and reliability of financial reports and corporate disclosures.

Following a Federal High Court decision in favour of the FRCN regarding the need for approval from National Office for Technology Acquisition and Promotion (NOTAP) for certain fees, the FRCN recently published 8 Financial Reporting Rules in March 2016.

Rule 4 of the FRCN's Rules specifically prohibits [illegible] nsactions in the financial [illegible] any if such transactions [illegible] provals that have not been [illegible] is rule was a direct outcome of the NOTAP case, the transactions contemplated are not limited to NOTAP as clearly articulated in the Rules. This means that the FRCN may also take interest in other regulatory approvals such as CAFA.

CAFA falls into this category of transactions and it potentially means that a company may not be able to recognise its non-current assets in the financial statements unless CAFA has been obtained for the relevant financial periods.

Conclusion

The drive for increased tax revenue continues to intensify due to the sustained downward pressure on oil prices globally and production challenges in Nigeria. By enforcing provisions in the laws that have been largely ignored in the past, the FIRS (working in conjunction with other government agencies) will be exploring new ways to generate more revenues from businesses.

In any event, some analysts have called for the abolition of the CAFA requirements for two main reasons:

1. **Relevance**

   It has been argued that CAFA is of no relevance and creates an extra burden without adding any value to business processes or the economy. CAFA is also seen as duplicating the role of the statutory auditor involving fixed asset verification. Perhaps the threshold of N500,000 was meant to limit the CAFA to a few high value assets but the devaluation of naira over time has resulted in the requirement being applicable to almost all assets.

2. **Difficulty in processing**

   The CAFA process is usually long and arduous, often taking between 3 months to 1 year or more before the certificate is finally obtained. The process involves initial validation of fixed assets schedules, description and classification; preparation and submission of application; asset verification and inspection; and the final certification. It is generally believed that the associated bottlenecks and bureaucracy creates an avenue for sharp practices.

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Presently, the provisions of the IIA still have the force of law in Nigeria. Pending any amendments or repeal of the requirements, it is important for companies to comply with its provisions in order to avoid potential tax exposures and sanctions by the FRCN.

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