

Nigeria's Finance Act 2020

Insights series and sector analysis





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Overview and general implications



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Overview and general implications

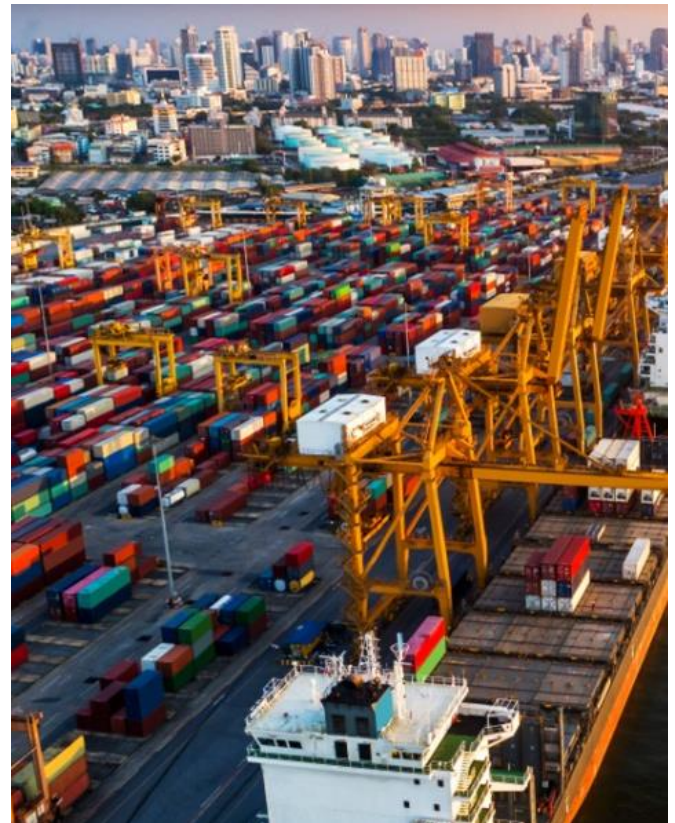
Economic context

The outbreak of COVID-19 pandemic led to a contraction of the Nigerian economy by -6.1% in Q2 2020 compared to 2.1% in Q2 2019. Mining and Quarrying contracted by 6.6%, Manufacturing by 8.8%, Real Estate by 22%, Insurance by 29.5%, Construction by 31.8%, and Trade by 16.6%. However, Information and Communication grew by 16.5%, Financial Institutions by 28.4%, and the agricultural sector remained resilient as it grew by 1.6% in Q2 2020. The GDP growth trend continued in Q3 2020 and for the rest of 2020.

Many key economic indicators did not move in the right direction. Inflation rose to 15.75% by the end of 2020, the highest in almost 3 years while unemployment remained high at over 27%.

Nigeria's total public debt increased by 18% to over N32.2 trillion as at the end of 2020 from N27.4 trillion recorded as at 31 December 2019. Meanwhile, disruptions to international trade flows as a result of the COVID-19 pandemic weighed heavily on foreign trade in 2020, with exports posting a significant decline of 45.5% in Q2.

Various monetary policy interventions and fiscal policy measures introduced by the government helped cushion the severity of the projected economic decline in 2020 while the Economic Sustainability Plan, the 2021 Appropriation Act and changes introduced via the Finance Act 2020, are expected to facilitate economic recovery and boost inclusive growth in 2021.



Highlights of the Finance Act 2020

In what is becoming an annual tradition, the Finance Act 2020 ("FA 2020") was passed by the National Assembly and signed into law by the President on 31 December 2020. The FA 2020 which comes into effect from 1 January 2021 complements the 2021 Federal Government's Budget of Economic Recovery and Resilience, anchored on the following key objectives:

- Adopt appropriate counter cyclical fiscal policies to respond to the economic and revenue challenges;
- Reform extant fiscal policies to prioritise job creation, economic growth and social economic development and domestic revenue mobilisation;
- Provide fiscal relief for taxpayers;
- Propose measures to fund the Federal Government's COVID-19 pandemic as well as any similar crises in the future;
- Ensuring coordination of fiscal, monetary and trade policies; and
- Reform the Fiscal Responsibility and Public Procurement Acts.

Covid-19 responses, fiscal reliefs and counter-cyclical measures

The FA 2020 provides for various reliefs in the form of tax deduction for donations made by companies to Covid-19 intervention funds; reduction of minimum tax payable by companies from 0.5% to 0.25% of turnover for the two years of assessment due between 1 January 2020 and 31 December 2021; exemption of small companies from education tax; use of courier service, email or any other electronic means for assessments and objections. Also, there is an exemption of compensation for loss of office up to N10 million from tax; exemption of low-income earners earning minimum wage or less from personal income tax; reduction of import duties and levy on vehicles; exemption of commercial flight tickets from VAT; and duty free importation of aircraft and aircraft components. These measures are designed to cushion the impact of the economic challenges triggered by the COVID-19 pandemic.

Overview and general implications

Fiscal reform and policy coordination

Various measures introduced by the FA 2020 in this regard include exemption of small companies from mandatory preparation of audited accounts (this aligns with the new provisions of CAMA 2020); use of technology by FIRS for tax administration including accessing information directly from taxpayers' accounting systems. Also, there is now a legal framework for the Tax Appeal Tribunal to conduct virtual hearing.

Capital allowance can now be claimed on software as a qualifying capital expenditure; deduction for life assurance premium on the life of the insured and his/her spouse has been reinstated after it was deleted by the Finance Act 2019. There is a restriction of deductible pension contributions to only schemes approved under the PRA; reform of commencement and cessation rules under the Personal Income Tax Act; definition of time and place of supply for VAT purposes; exemption of land and building from VAT; redesignation of stamp duty on bank transfers as Electronic Money Transfer (EMT) levy with a new revenue sharing formula (15% to federal government and the FCT, 85% to states). In addition, the FA 2020 provides for the creation of dedicated accounts by tax types for the payment of tax refunds; sanctions to ensure confidentiality of taxpayer information by tax officers; and requirement for free zone enterprises to file returns with the FIRS.

Budget funding and revenue mobilisation

New penalties have been introduced for violation of various requirements introduced by the FA 2020 including deliberate or dishonest acts to falsify tax returns. Other changes include provision of a legal framework for the introduction of excise tax on telecommunications services; introduction of Significant Economic Presence (SEP) rules for Technical, Management, Professional and Consultancy services provided by non-resident individuals and other unincorporated entities under PITA; expansion of VAT obligations of foreign companies doing business with customers in Nigeria; legal framework to strengthen exchange of information under various international treaties; redefinition of "gross income" for the purpose of Consolidated Relief Allowance (CRA) as income from all sources less all tax-exempt income and other tax deduction; expansion of the scope of taxable goods and services for VAT purposes; establishment of unclaimed funds trust fund to manage unclaimed dividends and dormant accounts balances; and clarification of the rules for the taxation of international shipping companies and airlines under CITA and CGT Act.

Fiscal responsibility and public procurement reforms

The FA 2020 introduced a limit of cost to revenue ratio at 50% for government owned entities or such other ratios as the Finance Minister via a Gazette upon the approval of the National Assembly may prescribe. In addition, government corporations are required to remit the balance of their operating surpluses to the Consolidated Revenue Fund of the Federation on a quarterly basis.

The Act also expands the definition of "contracts" by specifying parties to a procurement contract as the procuring entity and a consultant, supplier or contractor. The scope expansion of the Public Procurement Act and the definition of contract seek to capture all forms of procurement of services, goods and works by the public sector and all arms of government.



Takeaways

The Finance Act 2020 continues the tax reform measures introduced by the Finance Act 2019 and provides different frameworks to respond to the economic challenges brought about by the Covid-19 pandemic. The new finance act also clarifies a number of ambiguities identified in the previous amendments as well as other extant provisions of the various tax laws.

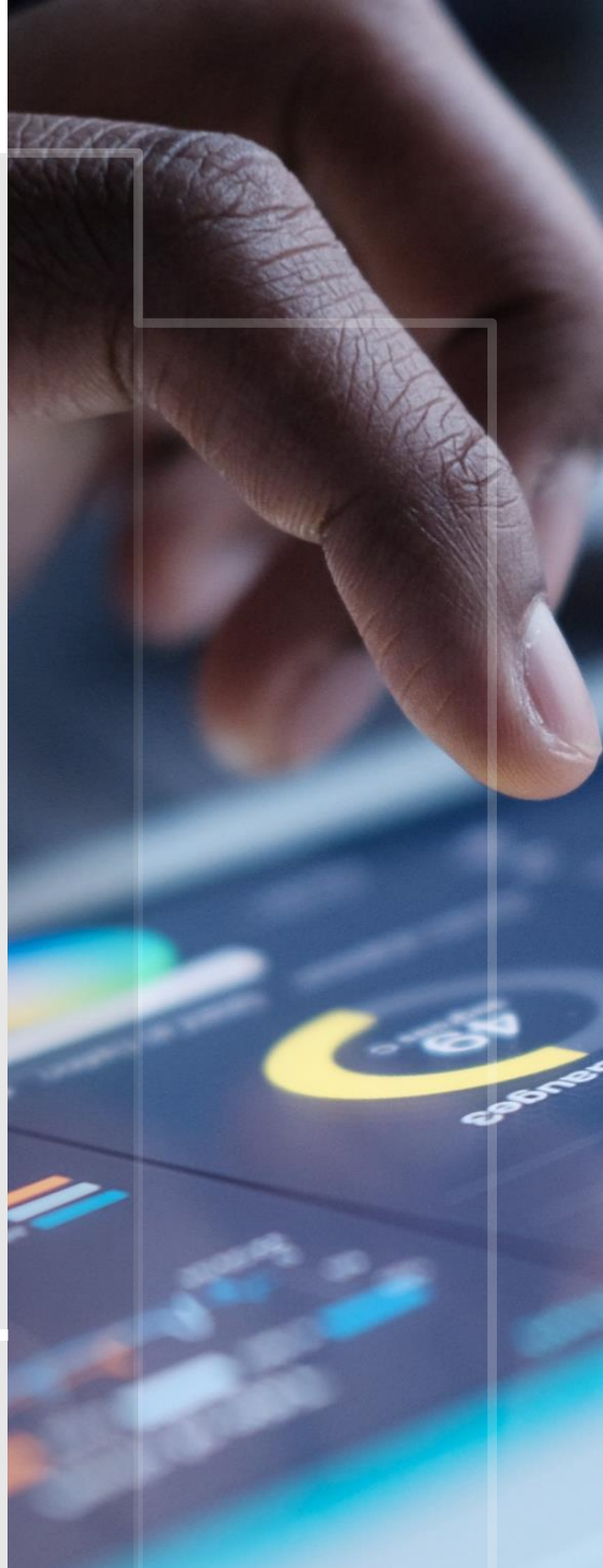
The changes underscore the government's resolve to continue to adopt and leverage technology in tax administration. Beyond tax, the FA 2020 extends to other legislation bothering on public procurement, fiscal responsibility, business regulations and trade policies. It is expected that government will continue to engage with key stakeholders to keep the reforms under constant review and make further changes as may be necessary in order to meet the intended objectives.



Implications for Non-residents and the digital economy



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Implications for non-residents and the digital economy

Overview

While Covid-19 ravages many sectors of the economy, the technology industry is generally considered as one of the few exceptions, and in fact a benefiting sector that is flourishing during the pandemic as businesses and individuals move online.

The FA 2020 introduces a number of changes that will impact non-residents persons who have business dealings with customers in Nigeria, including those that carry out digital, technical and other related activities remotely, i.e without having a physical presence or dependent agent in Nigeria.

Other key changes include documentary requirements for non-residents filing Companies Income Tax (CIT) returns; mandatory VAT registration; extension of the Significant Economic Presence (SEP) rules to non-resident individuals and other unincorporated entities; and provisions to enable the FIRS to adopt technology in gathering information, administering and collecting taxes on certain digital transactions with non-residents, among other changes. These amendments are examined below.



Submission of Global and Local Financial Statements

The FA 2020 requires non-resident companies (NRCs) that are taxable in Nigeria, including those that only create a Digital SEP, to file CIT tax returns comprising complete audited financial statements of their global operations (Global FS), as well as financial statements relating to their Nigerian operations (Local FS). The Local FS should be certified by an independent certified accountant in Nigeria.

NRCs are also required to submit tax computation schedules based on profits attributable to Nigerian operations; a statement depicting all profits from Nigeria, and duly completed CIT self-assessment forms. However, companies that earn passive income, and other income on which WHT is the final tax, will not be required to file returns.

This reinforces previous publications by the FIRS that requested NRCs to submit tax returns based on separate Nigerian accounts for income sourced from Nigeria ("actual profits"), as against the old practice of preparing income tax returns based on a percentage of Nigerian turnover ("deemed profits").

However, the FA 2020 does not provide specific guidance on how to determine profits attributable to Nigerian operations. Also, as the laws grant the FIRS the powers to assess companies on a deemed profits basis, it is likely that the FIRS may accept tax returns prepared on a deemed profits basis, in certain circumstances.

VAT registration requirement for non-residents

The FA 2020 requires non-resident persons that make taxable supplies of goods or services to customers in Nigeria to register for VAT and obtain a Taxpayers Identification Number (TIN), whether or not such non-residents have a physical presence in Nigeria. The FA 2020 generally defines taxable supplies of goods and services as supplies received and consumed by a person in Nigeria, regardless of the location of the supplier. Such non-resident persons are required to include Nigerian VAT on their invoices to Nigerian customers.

This provision introduces material administrative burden on many non-resident suppliers that should not necessarily be brought into the tax net. VAT on importation of goods is assessed by the Nigeria Customs Service at the ports and paid by the Nigerian customers. In the case of business-to-business (B2B) services and intangible goods, the Nigerian recipients are already required to account for and pay the applicable VAT under the reverse charge mechanism. With respect to services and intangible goods between non resident persons and individual customers (B2C), the new requirement may be able to capture some taxable transactions which previously escaped the tax net. However, this framework should be considered from both a practicability of enforcement perspective, and consistency with international best practices.

Implications for non-residents and the digital economy

Appointment of “fiscal representative” by non-residents for VAT purposes

A non-resident that makes taxable supplies to Nigeria may now appoint a representative in Nigeria for the purpose of complying with its tax obligations. It is expected that the FIRS would issue guidance in this regard.

Expansion of SEP rules to cover non-resident individuals and unincorporated entities

In line with changes to the Personal Income Tax Act (PITA), income from Technical, Management, Professional and Consultancy services remotely earned by non-resident individuals and other unincorporated entities will now be subject to tax in Nigeria, if such non-residents create an SEP in Nigeria. This is similar to the SEP rules recently introduced in CITA for NRCs. Withholding tax (WHT) deducted by Nigerian customers will be deemed as the final tax on such income. The Minister of Finance is empowered to define what constitutes an SEP in this regard.

Unlike CITA, PITA does not have express provisions that grant supremacy to Double Tax Agreements. This means that foreign individuals and other unincorporated entities that are resident in treaty countries, may likely be subject to the SEP rules under PITA.

Deployment of technology to automate information gathering

The FIRS is now empowered to deploy proprietary or third party payment processing platforms or applications to collect or remit taxes on digital transactions carried out with non-residents. The FIRS may also deploy technology to automate tax assessment and information gathering process, provided it gives 30 days notice to the taxpayer.

With these changes, the government seeks to tackle the difficulty in assessing and collecting tax on digital transactions with non-residents, especially on “business-to-customer (B2C) transactions, where the Nigerian customers are individuals that cannot self-account for and remit VAT. There may still be some practical challenges with implementing this approach considering the very fluid and complex nature of digital/online transactions.



Other matters

Minimum tax- This is the least amount of tax that companies must pay in any year of assessment where they have little or no taxable profits. The Minimum Tax which was set at 0.5% of gross turnover less franked investment income in the FA 2019 has now been reduced to 0.25% for the two tax returns that are due between 1 January 2020 and 31 December 2021.

There is a concern that Digital SEPs and other NRCs may be required to comply with Minimum Tax provisions going forward. This may be as a result of the deletion of the provision in CITA which exempted companies with a certain threshold of foreign ownership from minimum tax, thus exempting most NRCs who would usually fall within the threshold.

However, given the exemption from minimum tax for companies within their first 4 calendar years of business, digital SEPs will be shielded from the tax until year 5 after the commencement of the SEP Order.

Connecting the dots

The FA 2020 builds on some of the provisions of the FA 2019 around taxation of NRCs, especially those engaged in digital activities with Nigerian customers. However, some of the changes such as the requirement for all NRCs to file global as well as local financial statements, and to register for VAT in Nigeria if they make any taxable supplies, would result in additional compliance burden for the NRCs.

The amendments that grant the FIRS the powers to deploy technology in gathering information and tax collection, further indicate that the government is poised to collect as much tax as possible from the digital economy, and more broadly to curb tax evasion and aggressive avoidance by both resident and non-resident taxpayers.

Takeaways

The absence of clear guidelines on the attribution of profits for digital SEPs creates uncertainties for affected taxpayers. The FIRS may need to engage stakeholders with a view to designing a framework that clarifies this area. It is expected that an amended SEP Order will be issued by the Finance Minister to define the new SEP framework under PITA and address some of the practical challenges with the existing SEP provisions introduced via the FA 2019 and the current SEP Order.



Implications for the Banking Sector and Capital Market



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Implications for the Banking Sector and Capital Market

Background

The financial services sector remained resilient through the third quarter of 2020. Sector growth in Q3 2020 was at 9.6% higher than the 3.25% recorded in the corresponding quarter of 2019.

The lockdown in Q1 and subsequent restrictions fueled growth in the volume and value of online transactions, e-payments and virtual banking. Data from the National Bureau of Statistics revealed that the volume and value of online transfers grew by 21% and 38% in Q3 2020 relative to Q2 2020. For mobile app transfers, the volume and value grew by 30% and 26.3% respectively over the same period.

The CBN introduced and sustained various credit interventions and other monetary policy measures designed to ensure that the financial sector continues to support the economy. The apex bank maintained the low interest rate environment to encourage the availability of affordable credit to the real sector. This in turn also led to increased activities in the capital market.

The Nigerian Stock Exchange (NSE) was ranked as the world's best-performing stock market in 2020 according to analysis provided by Bloomberg. The NSE All Share Index closed at 40,270.72 index points with capitalisation at N21.06 trillion, and its YTD returns stood at about 50% as at the end of December 2020.

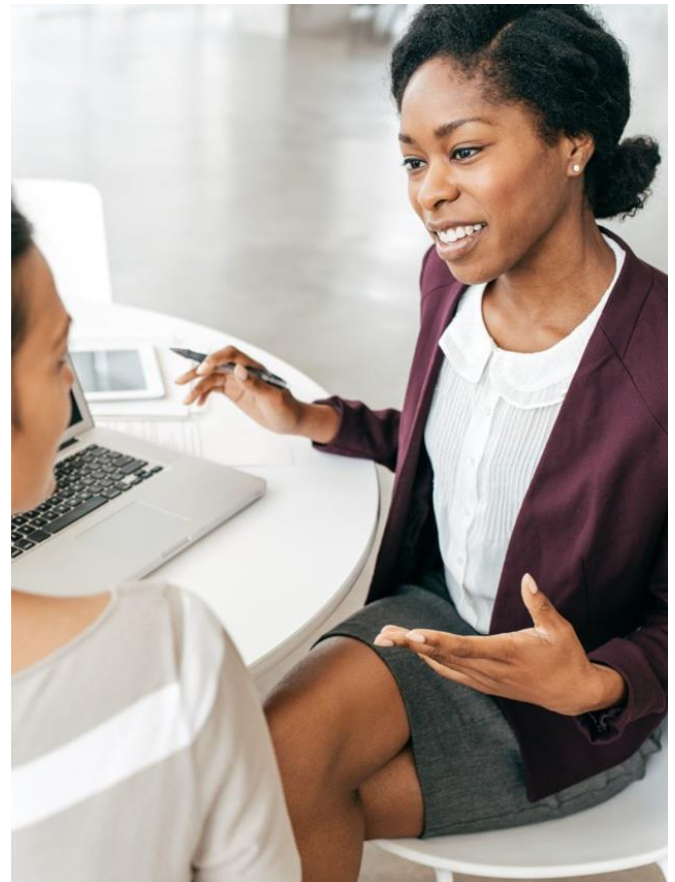
The 2020 Finance Act introduced many changes which will affect the banking and capital markets sector. Significant among these changes are the following:

Introduction of Electronic Money Transfer (EMT) Levy

The Finance Act 2019 introduced the legal framework for the imposition of stamp duties on electronic transactions via an amendment to section 89(3) of the Stamp Duties Act (SDA). Prior to the amendment, the imposition of stamp duty of bank transfer was premised on a decision of the Court and the directive issued by the CBN to money deposit banks.

The 2020 Finance Act has now modified section 89(3) of the SDA to remove electronic transfer from the scope of stamp duty and introduced an "Electronic Money Transfer" levy which is applicable on electronic receipts or electronic transfer for money deposited in a financial institution, on any type of account. The applicable levy is N50 on any transfer of N10,000 or more.

The Minister of Finance is required to make regulations for the administration of the EMT Levy after receiving the necessary approvals from the National Assembly. The revenue collected from the EMT levy is to be shared based on derivation 15% to the federal government and the FCT and 85% to the states.



Unclaimed dividends of publicly quoted companies and unutilised funds in dormant accounts of deposit money banks

The new Companies and Allied Matters Act (CAMA) 2020 allows shareholders to claim their dividends declared by a company within 12 years, otherwise such dividends revert to the company to be redistributed to other shareholders.

Based on Section 60 of the 2020 FA amending section 432 of CAMA, dividends unclaimed for a period of 6 years or more after declaration are to be transferred to the Unclaimed Funds Trust Fund (UFTF). Such unclaimed dividends will be treated as a special debt owed by the federal government and will be available to be claimed by the rightful shareholders at any time from the UFTF.

Also, the 2020 FA requires deposit money banks to transfer any unclaimed balances in dormant accounts outstanding for at least 6 years to the UFTF. All public listed companies on the NSE and DMBs are required to render returns to the Debt Management Office (DMO) accordingly.

Implications for the Banking Sector and Capital Market

International tax treaty and other exchange of information obligations

All banks, insurance companies, stockbroking firms or any other financial institutions are required to prepare and submit (as may be specified by the FIRS), returns of transactions involving the specified sum; names, addresses or any other information of their customers connected with those transactions; or names, addresses, or any other information of new or existing customers. Failure to comply attracts a penalty of N25,000 for the first month of default and N10,000 for each subsequent month the default continues.

The new requirement is driven by the multilateral treaty on exchange of information to which Nigeria is a signatory.

Ability of banks to benefit from tax incentives on loans granted for primary agricultural production

The 2020 FA streamlines the scope of the incentive on which banks can benefit from granting loans to the agricultural industry. Previously, loans granted for any agricultural trade or business are eligible for the incentive. However, this amendment has restricted the incentive to only primary agricultural production defined as primary crop production, primary livestock production, primary forestry production and primary fishing production.

Furthermore, the Act reduces the moratorium period from 18 months to 12 months to encourage banks to provide these loans.

Further clarifications regarding taxation of Real Estate Investment Companies (REICs)

The FA 2019 introduced the exemption of dividend and rental income earned by a REIC from companies income tax (CIT), provided that a minimum of 75% of the dividend or rent is distributed within 12 months of the end of the financial year in which the income was earned. The FA 2019 further provided that any undistributed dividend and rental income after 12 months would be subject to tax.

This implies that even though a REIC may have met the minimum distribution requirement, it will still be taxed on its undistributed dividend or rental income. The FA 2020 has now addressed this problem by clarifying that the full dividend and rental income of a REIC will be exempt from CIT if at least 75% is distributed within 12 months after the year-end in which the income was earned.

Other Changes in the Companies Income Tax Act

- **Reduced minimum tax rate:** The FA2020 introduces a reduced minimum tax rate of 0.25% of gross turnover for income tax returns due between 1 January 2020 to 31 December 2021 implying that companies liable to pay minimum tax will benefit from a reduced tax rate for the period specified.
- **Deductibility of donations:** companies now have the legislative backing to take deductions for contributions made to a fund set up by the government to respond to any disasters and mishaps (including funds set up for Covid-19 interventions).
- **Notice of assessments from the FIRS and objection letters from the taxpayers** can now be served electronically
- **Undisputed assessments** are now payable within 30 days after the service of the notice of assessment (previously 60 days).

Changes in the Capital Gains Tax (CGT) Act

- **Remittance of CGT:** There is a requirement to self-assess and remit CGT due not later than 30 June and 31 December of the same year upon the disposal of a chargeable asset.
- **Compensation for loss of office:** Only the excess above N10m is chargeable gains to CGT at 10%. The employer is required to deduct and remit the CGT within the time specified for the payment of PAYE tax.



Implications for the Banking Sector and Capital Market

Takeaways

Most of the changes that affect the banking sector and capital market impose compliance obligations on companies operating in the sector which is likely to increase the cost of doing business. The industry is saddled with the responsibility of accounting for the EMT levy, remitting the unclaimed dividend of public listed companies and unutilised funds in dormant bank accounts to the UFTF, rendering additional returns to the DMO with respect to the UFTF and submitting returns to the FIRS with respect to the international tax treaty and exchange of information obligations.

A few changes however will have positive impacts including the relaxation of the moratorium for eligible agricultural loans although the scope of eligible agricultural trade or business has been restricted to primary agricultural production. Also, the amendment in respect of Real Estate Investment Companies will positively impact the Real Estate segment of the capital market. In addition, clarity has been provided by the amendments on previously ambiguous provisions of the law. This is expected to reduce uncertainties and tax controversies.

What is clear is that the government is in search of revenue and funding to plug budget deficits and address the country's low tax to GDP ratio. It is therefore likely that the government will continue to focus on reforms designed to promote growth in the banking sector and capital market while keeping their activities under scrutiny for potential revenue mobilisation opportunities.





Implications for the Insurance Industry



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Implications for the Insurance Industry

Background

Insurance penetration in Nigeria is estimated at 0.7%, below the Africa average of 3%. This shows that there is significant potential and opportunity for growth in the sector. The sector's GDP declined by 16.54% in Q3 2020, compared to a growth of 6.69% recorded in Q3 2019, a decline of 23.23% year on year. The decline can be partly attributed to the impact of the economic downturn as a result of the Covid-19 pandemic.

While some level of recovery is expected in 2021, the key challenges are likely to linger for longer. These include the need for increased capital base, poor insurance culture, regulatory framework to enforce compliance, socio-cultural factors and uncertainties in the macroeconomic environment. The Finance Act 2020 introduced some changes that will affect the Insurance companies. We have analysed these below.



Life business

Companies Income Tax Act

a) Reduction in minimum tax rate

The minimum tax rate has been reduced from 0.5% to 0.25%. This reduced tax rate applies to income tax returns due and filed between 1 January 2020 and 31 December 2021.

Analysis – This reduces the tax burden for life insurance companies for two (2) years of assessment for income tax returns due and filed between 1 January 2020 and 31 December 2020. The reduction in the tax rate has retrospective application since the Finance Act has a commencement date of 1 January 2021. However, given that the change results in a tax benefit, there is unlikely to be a push-back from affected taxpayers.

Affected companies would have the option to refile their 2020 year of assessment tax returns in order to claim a refund or apply any excess as credits for future years.

b) Definition of “gross income”

For the purpose of minimum tax, section 9(b) of the Finance Act 2020 states the tax base for life insurance as “gross income” defined as the total income earned by a life insurance business including all investment income (excluding franked investment income), fees, commission and income from other assets but excluding premiums received and claims paid by re-insurers.

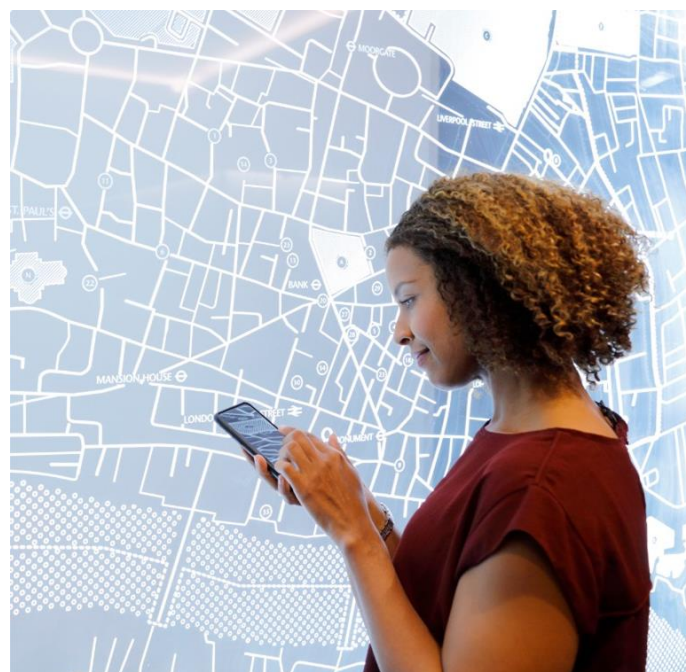
Analysis – Prior to the definition, there were several interpretations of the term “Gross income” leading to different tax outcomes, tax disputes and uncertain tax positions. The exclusion of franked investment income such as dividend that has suffered WHT aligns with a similar exclusion in the definition of gross turnover, for other companies.

Personal Income Tax Act

a) Tax deduction for premium paid for life assurance and deferred annuity policies

The Finance Act 2020 restores the tax deduction for the annual premium paid by a taxpayer on a preceding year basis to an insurance company for a life policy on his life or the life of his spouse or a contract of deferred annuity.

Analysis – The tax relief existed prior to the Finance Act 2019 which appeared to have deleted the provision in error. The FA 2020 amendment is expected to encourage individuals but life policies and deferred annuity contracts. The change however does not address the ambiguity in situations where a life assurance policy or deferred annuity contract includes a savings component.



Implications for the Insurance Industry

Non-life business

a) Reduction in the Minimum tax rate

Same as (a) above

b) Definition of “gross premium”

For the purpose of minimum tax, section 9(b) of the Finance Act 2020 defines “gross premium” as the total premiums written, received and receivable excluding unearned premium and premiums returns to the insured.

Analysis – This is a welcome development as this definition provides clarity regarding application of minimum tax for non-life businesses and prevents the possibility of the FIRS defining the term to include total premium received/receivable excluding premium returned to the insured. This helps to reduce the tax base for minimum tax purposes and should help the industry better able to recover from the COVID 19 pandemic and economic recession.



Other changes

Federal Inland Revenue Service (Establishment) Act

a) Information to be delivered by Insurance companies

The Finance Act 2020 amends section 28 of the Federal Inland Revenue Service (Establishment) Act “FIRSEA” to obligate insurance companies to prepare and file returns in fulfillment of an international tax treaty and other exchange of information obligations as prescribed by the FIRS through notice, rules, regulations, guidelines or circulars.

Analysis – This provides further legal backing to the FIRS Income Tax (Country by Country Reporting) Regulations 2018 and Income Tax (Common Reporting Standards) Regulations 2019. Insurance companies that meet the compliance threshold will continue to comply. The amendment includes an administrative penalty for non-compliance of N25,000 for the first month and N10,000 for each subsequent month in which the failure continues. Where this penalty conflicts with the penalty stated in the regulations, the provision of the FIRSEA will supersede.



Connecting the dots

Despite the many positive fiscal changes introduced by the Finance Act 2019 and 2020, certain changes are required to facilitate capital raising, reorganisation or business combination in view of the impending increase in minimum capital requirements for various insurance businesses. For instance, the minimum holding period of 365 days for tax neutral corporate reorganisation and the deletion of the provision that exempts bonus dividends from withholding tax, limit the scope for tax efficient recapitalisation.

By facilitating the insurance sector, the government would be limiting the social pressure on it and the need to support individuals and businesses that suffer losses during a crisis or other challenging period.

Takeaways

The new changes provide the much needed clarity regarding taxation of insurance business. The disruption to businesses and livelihoods caused by the COVID-19 pandemic and the recent social unrest reaffirms the key role the insurance sector plays in the economy to limit economic disruptions or damages and facilitate recovery. It is therefore important to sustain and enhance the various reforms designed to stimulate growth within the sector, fiscal and otherwise.



Implications for the Energy and Utilities Sector



05



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Implications for the Energy and Utilities Sector

Background

The Finance Act 2019 brought about a lot of changes to the Energy and Utilities Sector. In addition, Covid-19 significantly impacted the sector as reflected in the sharp decline in crude oil prices and subsequently depressed demands leading to production cuts. The long-awaited Petroleum Industry Bill (“PIB”) was reintroduced as the Bill for consideration by the National Assembly. The power sector also had its share of challenges ranging from rising cost due to naira devaluation, value chain disruption and tariffs management.

Summary

The Finance Act 2020 introduces a few but significant changes that affect companies in the Energy and Utilities Sector. These changes include; new requirements for companies in the oil and gas free trade zone, clarification on the application of gas utilisation incentives only to the trade or business from the same operation (and not to the entire company), and the reduction of minimum tax rate from 0.5% to 0.25% of turnover for two years of assessment falling due between 1 January 2020 and 31 December 2021.



Specific Changes in the Finance Act 2020

Tax filing requirement for entities in the free zone

The Finance Act 2020 amends section 18 of the Nigeria Export Processing Zones Act as well as the Oil and Gas Export Free Zone Act by removing the exemption which relates to taxes, duties, levies and foreign exchange. This means that companies operating within the zones are now subject to other provisions of the Companies Income Tax Act (CITA) and the provisions of the Banks and other financial Institution Act (BOFIA) 2020. Prior to the amendment, companies operating in the zone were not mandated to file tax returns with the FIRS. Going forward, the implication of the amendment is that companies operating in the Oil and Gas Export Free Zone are expected to comply with Section 55 of CITA to file their CIT returns with the FIRS whether they have tax liabilities or not. Failure to do so will attract the penalties stipulated in CITA and the FIRS establishment Act.

It is expected that the information provided will enable the FIRS to determine the scope of the operations of such companies which are covered by the free zone exemption and those that are not.

Rationalisation of gas utilization incentive

The FA 2020 introduces a new amendment for companies benefiting from the gas utilisation incentives. It restricts the incentive to apply only in respect of the gas utilisation operations of a company, rather than to the company as a whole. The tax-free period of the trade or business will start

on the day the trade or business commences production as certified by the Ministry of Petroleum Resources. In addition, any company that has claimed an incentive for gas utilisation in Nigeria under any law including the Petroleum Profit Tax Act (PPTA), or Industrial Development (Income Tax Relief) Act (IDITRA) cannot enjoy the gas utilisation incentive for the same qualifying capital expenditure. For example where a company has enjoyed the upstream gas utilisation incentive, it cannot transfer the same asset to another company or SPV and claim gas utilisation under CITA or apply for the pioneer incentive under IDITRA.

Minimum Tax

The Act introduces a reduced minimum tax rate of 0.25% (previously 0.5%) of gross turnover less franked investment income for tax returns prepared and filed for any year of assessment falling due between 1 January 2020 and 31 December 2021 both days inclusive. This amendment seeks to address the challenges faced by businesses as a result of the COVID-19 pandemic. With the current economic realities, it would be difficult for many businesses to meet up with their income tax obligations. This incentive will therefore help reduce the tax burden on companies with low margin such as downstream petroleum businesses.

Implications for the Energy and Utilities Sector

Takeaways

Companies that are eligible for the gas utilisation incentive need to properly analyse the various incentives options available to them and the potential tax implications and benefits before deciding on the incentive to apply for.

Minimum tax has had an adverse impact on the Energy and Utilities Sector, in particular the downstream petroleum marketing and the power distribution sectors. This rate reduction of minimum tax is therefore a welcome reprieve for the affected companies. The amendment prescribes a retrospective application by referring to the 2020 (YOA) year of assessment even though the Finance Act 2020 has a commencement date of 1 January 2021. This means companies who have filed and paid minimum tax at the rate of 0.5% could refile their returns for 2020 YOA, apply for refunds or carry forward the excess payment to future years.

The minimum tax regime places a huge burden on a company that has not generated sufficient taxable profits, which may be due to circumstances outside its control such as a downturn in the economy or by reason of operating in a high volume but low margin industry. Affected companies who may be struggling to stay afloat are effectively being asked to pay tax from their capital or borrowing. To address these challenges and create a more conducive tax environment for businesses, the minimum tax regime should be abolished. Companies involved in artificial loss making can be identified through a risk-based tax audit process and tax intelligence.





Implications for the Agricultural industry



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Implications for the Agricultural industry

Background

The agricultural sector grew by 1.4% in real terms in Q3 2020 compared to 2.3% in Q3 2019 and 1.6% in Q2 2020. The performance in Q3 2020, which was lower than the two periods compared, was caused by a contraction in the fishing subsector.

However, some drawbacks to the sector, such as the farmers-herders' conflicts, insecurity in the northern region, widespread adoption of unsophisticated farming techniques, among others, still persist.

Current policies introduced by the stakeholders to foster the performance of the agricultural sector in Nigeria includes Federal Capital Territory training of farmers on pest control, a

COVID-19 recovery and resilience intervention by Value Seeds, in partnership with Mastercard, to supply seedlings to female farmers.

Despite the recession of 2016, and the current economic downturn as a result of the global health crisis, the sector's performance has been largely above the overall economy. In terms of its contribution to overall economic activities, the sector has maintained over 20% share of the Real GDP. Notably, in Q3 2020, Agriculture's contribution rose to a high of 30%.

In general, Nigeria's agricultural sector has recorded a steady growth overtime, at an average of 3% in the last five years but the country is yet to attain food sufficiency.

Key changes introduced by the finance act 2020

Companies Income Tax

Section 6 of FA 2020 and Section 11 of CITA:

Section 6 of the Finance Act amends Section 11 of CITA by exempting from tax interests on bank loans granted to companies engaged in primary agricultural production provided the moratorium exceeds 12 months and the interest rate is not more than base lending rate at the time the loan was granted, refinanced or restructured.

The Act also defined primary agricultural production. Previously the exemption related to loans granted to companies engaged in "agricultural trade or business", and the minimum moratorium period was 18 months.

Analysis:

The replacement of "agricultural trade or business" with "primary agricultural production" means that only companies whose principal business involves crop production, livestock, fishing and forestry would be able to benefit from the incentive as lenders would be encouraged to grant loans to such businesses to qualify for the exemption.

The reduction of the minimum moratorium period to 12 months will encourage banks to give more loans to the sector as the threshold for being eligible for the exemption has now been reduced. It is expected that this will boost production and create employment opportunities in the primary production subsector and ultimately the overall agricultural sector. On the other hand, it means the companies have to begin paying the interest on the loans at least 6 months sooner which may create working capital and liquidity challenges for affected businesses especially if their produce requires a longer gestation period.

Also, the introduction of "refinancing or restructuring" in the section now means that existing loans can be reviewed to take advantage of the incentive. Previously the law only referenced the moratorium at the time the loan was granted. This expands the scope of beneficiaries and credit facilities eligible for the incentive.

Sections 10 and 23 of the FA 2020 (amending section 23 of CITA and section 1 of IDITRA respectively)

Section 10 of the FA 2020 removes the tax-free period of five to eight years granted to companies engaged in 'Agricultural production' in the Finance Act 2019. In addition to the deletion of this provision, section 23 of FA 2020 (which amends section 1 of the IDITRA) introduces new provisions granting tax holiday to companies whose primary activity is agricultural production. Specifically, the section grants a tax holiday of an initial four years, and an additional maximum period of two years to Small and Medium sized companies engaged in primary agricultural production. The extension is subject to satisfactory performance. Eligible companies are required to apply to the President through the Minister for Trade, Industry & Investment. Companies that benefit from the incentive are precluded from enjoying similar incentives under the law.

Analysis:

The amendments remove the previous duplication of tax holidays granted under CITA and IDITRA. The tax holiday is now to be administered in a similar manner as the pioneer incentive scheme by the Nigerian Investment Promotion Council (NIPC), being the agency with delegated responsibility to manage the scheme. Eligible companies would still be required to meet the more formal requirements of the NIPC to enjoy the incentive. The amendment rationalises the tax expenditure on the incentive given that the category of eligible companies is now streamlined, and the pioneer period reduced.

Implications for the Agricultural industry

Background

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However, some drawbacks to the sector, such as the farmers-herders' conflicts, insecurity in the northern region, widespread adoption of unsophisticated farming techniques, among others, still persist.

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Despite the recession of 2016, and the current economic downturn as a result of the global health crisis, the sector's performance has been largely above the overall economy. In terms of its contribution to overall economic activities, the sector has maintained over 20% share of the Real GDP. Notably, in Q3 2020, Agriculture's contribution rose to a high of 30%.

In general, Nigeria's agricultural sector has recorded a steady growth overtime, at an average of 3% in the last five years but the country is yet to attain food sufficiency.

Key changes introduced by the finance act 2020

However, there is also the consideration that currently, the minimum capital asset requirement to qualify for pioneer incentive under the NIPC guidelines is N100m whereas the range of turnover for eligible companies is a maximum of N100m. It is doubtful if many small and medium sized primary agricultural production companies will have this level of capital assets.

Customs and Excise Duties

Section 38 of the FA 2020 and First Schedule to the Customs and Excise Tariff Act (CETA)

Reduction of Import Duty: Section 38 of the Finance Act amends the CETA to reduce the import duty on Tractors from 35% to 5% while the import duty on Trucks and other vehicles for the transport of goods was reduced from 35% to 10%.

Analysis:

Companies in the agricultural sector rely heavily on vehicles to transport their products from the farms to markets across the Country. They also rely on machineries such as tractors in the farming process. The reduction of the import duty on motor vehicles for transport of goods is expected to trigger a reduction in the cost of these vehicles and the operational cost of getting the farm produce to off-takers or the market. Also, the reduced cost of tractors will help aid production.

Value Added Tax Act

Section 45 of FA 2020 and First Schedule to the VAT Act

Lease of Agricultural equipment: Section 45 of the Finance Act introduces "Hire, rental or lease of tractors, ploughs and other agricultural equipment for agricultural purposes" to the list of exempt services in the First Schedule to the VAT Act.

Analysis:

The First Schedule to the VAT Act previously included "purchase of tractors, ploughs, and other agricultural equipment" as exempt goods. Given that the bulk of farmers, especially small holders cannot afford outright purchase of equipment, expanding the list of exempt services to include hire, rental or lease of tractors, ploughs and other agricultural equipment is expected to drive down production and transportation costs for the majority of farmers. This exemption may also encourage mechanized farming in Nigeria which will enhance production capacity and quality of produce.

Section 44 of FA 2020 and Section 46 of the VAT Act

Section 44 of FA 2020 introduces new definition for - "animal feed"

Analysis:

Animal feed is included in the list of Basic Food Items exempted from VAT in the First Schedule to the Act. The definition of animal feed included in the amendment seeks to provide clarity on what constitutes animal feed. This clarity provided by the Act will benefit the livestock farmers. It is expected that the price of animal feed will fall and this should ultimately reflect in lower prices of the final products.



Implications for the Agricultural industry

Connecting the dots

The Federal Government sent a bill titled the “Transmission of the Finance Act, 2019 (Amendment) Bill to the National Assembly after the passage and signing of the Finance Act 2019. The Bill seeks to introduce a few changes to the Finance Act 2019 including the addition of Animal Feed to the list of exempt Basic Food items. The definition of animal feed in the Finance Act 2020 appears to be a fallout of the proposed amendments.

The tax-free holiday for agricultural production companies previously under CITA was introduced by the Finance Act 2019. This incentive has now been moved to IDITRA. This is in line with the intention of the Government to have agriculture as one of the sectors eligible for pioneer status incentive while ensuring that the incentive follows the standardised process under IDITRA.

Takeaways

The amendments reinforce the government’s drive to further diversify the economy through agriculture. The tax holiday and exemption of VAT on hire of agricultural machinery should facilitate development in the sector. It is expected that more investors will now be willing to invest in the sector.

However, most of the incentives are aimed at the primary agricultural production subsector. It might be worthwhile for the government to consider gradually expanding the scope of these incentives to other sub-sectors of the industry to promote scale, value addition and position for exports under the AfCFTA.

Apart from production, lack of adequate infrastructure is a major challenge in the industry. Agricultural products are still moved across the country on bad roads leading to wastage of products. Storage infrastructure for the produce is lacking in most places. Government and private sector investors will need to equally focus on providing the necessary infrastructure to complement the primary agricultural production and optimise value for the industry.





Implications for the Consumer and Industrial Products Industry



07



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Implications for the Consumer and Industrial Products Industry

Background

The Consumer and Industrial Products industry in Nigeria grapples with many challenges including high costs of production, supply chain issues, inadequate infrastructure, multiple taxes and falling consumer demand. These challenges have been compounded by the COVID-19 pandemic. Many companies in the sector had to scale down production significantly or stagger their production due to the lockdown and other government-imposed restrictions. This significantly affected businesses like restaurants and bars, and impacted on consumption of food, beverages and related products.

Many businesses faced the challenge of maintaining safety of their staff within their premises and manufacturing plants given that some of the jobs cannot be done remotely.

The government continues to seek viable means of diversifying the economy and so the Finance Act (or "FA") 2020 has a number of provisions aimed at cushioning the effect of the pandemic and stimulating growth in the industry. We provide highlight of the changes affecting the industry below.



Changes introduced in the Finance Act 2020 and Analysis

Deductible Donations

Donations made in cash or kind to any fund set up by the Federal or State Government in respect of any pandemic or natural disaster are now deductible up to a maximum of 10% of the companies' assessable profits after deduction of other allowable donations. The deductible amount for in-kind donations will be the cost of purchase, manufacture or supply. Previously donations were deductible only if they are made to any of the bodies listed on the fifth schedule, and not of a capital nature.

Some companies in this sector made donations to the Federal and State Governments in respect of the COVID-19 pandemic. With the country currently experiencing a second wave of the virus, this will not only provide relief for companies that have donated but also encourage others to do so. However, the cap of 10% of assessable profit placed on the deduction may discourage companies who have little or no assessable profits due to the pandemic.

Reduction in Minimum Tax Rate

The Act reduced the minimum tax rate to 0.25% for tax returns due and filed between 1 January 2020 to 31 December 2021. Prior to the amendment, a minimum tax rate of 0.5% applied for all years of assessment. This amendment will reduce the tax burden on many companies who may be unprofitable during the period

and have to pay the minimum tax based on their turnover. Given that returns that are due for 2020 have been filed by many affected companies, it may be necessary to refile the returns, apply for a refund or seek to carry forward the excess minimum tax paid to future periods.

Redefinition of "Gross Turnover"

- "Gross Turnover" has been redefined as the gross inflow of economic benefits during the period which results in an increase in equity other than equity contributions. The previous definition of 'gross turnover' in the FA 2019 listed cash, revenues, receivables and other assets as economic benefits to be considered as part of 'gross turnover'. These have been removed in the FA 2020 definition.
- The key issue is that only inflows from operating activities should constitute gross turnover for this purpose. For instance, while interest income will form part of the turnover for a Bank it may be outside the ordinary activities of a manufacturer and therefore excluded.

Implications for the Consumer and Industrial Products Industry

Capital Allowance on Software

Capital expenditure incurred on the development or acquisition of software or other electronic applications are now qualifying expenditures eligible for capital allowance claim. This is expected to incentivize companies to invest in developing or acquiring software and electronic applications which can improve their production process. However, in some cases it may result in a tax cash flow disadvantage for companies who are able to claim their full expense in one year for tax purposes. Also the 2nd schedule was not updated to include the rate of initial allowance and annual allowance for software. In the absence of any guidance from the FIRS, a company may choose the most appropriate classification to be adopted for capital allowance purposes on software.

Excise Duties on Imported materials and goods

The Finance Act 2019 provided for excise duty on goods manufactured in, and those imported into Nigeria except goods and raw materials that are not locally produced or available in Nigeria. The Finance Act 2020 has now removed the exemption of excise duty on goods and raw materials not locally available in Nigeria. This implies that all imported goods and raw materials whether available in Nigeria or not contained in the fifth schedule are now subject to excise duties.

Reduction of import tariffs on vehicles

Import duty on Motor Vehicles used for the transport of goods has been reduced from 35% to 10%. Also, the import levy on cars has been reduced from 35% to 5%. Companies in the industry rely heavily on vehicles to transport their goods and cars as operational vehicles. The reduction of the import duty on motor vehicles will lead to cost reduction in the medium to long term, which will also reduce the cost of operation of companies in this sector.

Amendments to the VAT Act

- **Intangible assets have been reclassified from goods to services** - The Finance Act 2019 introduced intangible assets as taxable goods for VAT purposes. In principle, it means any input VAT can be claimed on such assets. Under the Finance Act 2020, intangible assets and incorporeal are now classified as services, which means that there is no scope for claiming input VAT on such items. FA 2020 also clarifies that an incorporeal is taxable in Nigeria if the right is exploited by a person in Nigeria, registered in, assigned to or acquired by a person in Nigeria; or is connected with a tangible or immovable asset in Nigeria.

- **Time of Supply:** The Act clarifies the time of supply of goods and services for connected and unrelated parties. For unrelated parties, supply is deemed to take place upon issue of receipt or invoice by supplier, or payment of consideration is due to, or received by supplier in respect of that supply, whichever occurs first. For connected parties, certain intercompany transactions may be subject to VAT where a supply is deemed to have occurred as defined in the Act whether an invoice is issued or not.
- **Supplies with Periodic Payments:** When goods are supplied under any rental agreement or services are furnished under any agreement which provides for periodic payment, time of supply will be earlier of when payment is due or is received or invoice relating to payment is issued.

When goods are supplied under an instalment credit agreement, supply takes place at the earlier of when goods are delivered, or payment is received. This amendment will impact various contracts such as Engineering, Procurement and Construction contracts (EPC).

- **Time of Payment:** Regardless of when a supply takes place, it does not change the time for VAT payment. Based on the amendment introduced by the FA 2019, output and input VAT are to be accounted for on a cash basis, i.e. when the VAT is collected or paid respectively. VAT deducted at source or self charge VAT may be due immediately supply occurs.
- **VAT obligation of non-residents:** Previously, non-resident persons are required to register for VAT if they 'carry on business' in Nigeria. This condition has now been modified such that a non-resident person has to register for VAT if makes a taxable supply of goods and services to customers in Nigeria. This implies, for instance, that non residents providing technical or management services to Nigerian companies will be required to register for VAT, even though the Nigerian customer has the responsibility to account for the VAT on those transactions.



Implications for the Consumer and Industrial Products Industry

Redesignation of Stamp Duty on bank transfers as Electronic Money Transfer

The Finance Act 2020 has replaced the stamp duty of N50 payable on electronic receipts or transfers of N10,000 or more with a new charge called the "Electronic Money Transfer (EMT) Levy". It is applicable on electronic receipts or electronic transfer for money deposited in a financial institution, on any type of account. The levy is a one-off N50 charge on electronic receipts or transfers of N10,000 or more.

The potential downside to this new provision is that it does not include the previous exemption on electronic transfers made between accounts of the same owner within the same bank. This means that such transfer will now be subject to the EMT levy.

Tax Refunds

To ease the refund process, the FIRS will operate tax refund accounts for each tax type, which will be funded from the respective tax revenue. It is expected that this amendment will lead to more funds being appropriated for tax refunds by tax types to facilitate the refund claim process.

Connecting the Dots

With the ratification of the African Continental Free Trade Area (AfCFTA) agreement by Nigeria, it is important that local laws are reviewed in readiness for AfCFTA implementation. While the reduction in import duties on motor vehicles for the transport of goods is expected to reduce cost of transportation overtime, it may also be a disincentive to local assembly plants. However, import tariff alone may not be sufficient to protect the local assembly plants given that cars manufactured in other African countries under the AfCFTA are expected to be free of tariffs when imported to Nigeria.

The introduction of the requirement for companies to keep financial and accounting records for at least six years from the year of assessment now aligns with a similar provision which has always been in the Companies and Allied Matters Act. Companies now have a provision in CITA to rely on when responding to requests for documents from the tax authority in respect of back duty audits.

Takeaways

While many of the changes introduced by the Finance Act 2020 are expected to simplify the ease of doing business, some of the changes in fact create additional compliance burdens for taxpayers. Businesses are encouraged to identify specific changes that will impact them in order to take advantage of the opportunities presented while putting in place processes to deal with any additional compliance requirements and to manage risks arising.

As the covid-19 pandemic continues to affect businesses in this industry, it is important that the tax laws provide needed relief and promote the ease of doing business in Nigeria. It is expected that subsequent reviews of the tax laws will continually address these issues and harmonise the tax laws with other regional and continental agreements.





Implications for Micro, Small and Medium-Sized Enterprises



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Implications for Micro, Small and Medium-Sized Enterprises

Background

The Micro, Small and Medium-Sized Enterprises (MSME) sector, according to the World Bank, represents about 90% of businesses and more than 50% of employment worldwide. The sector is essential to Nigeria's growth, contributing to its development and poverty reduction. The National Bureau of Statistics report shows that MSMEs contributed about 50% of GDP in 2020.

While there is potential for government to generate revenue from MSMEs, a more sustainable strategy is to exempt small businesses from burdensome tax obligations and incentivise them to grow and formalise as they scale their operations.

The 2020 Finance Act introduces changes to various tax laws that specifically impact MSMEs and ultimately the broader economy. We highlight these changes and the implications for MSME stakeholders.



Key provisions of the Finance Act 2020

Companies Income Tax Act (CITA)

Minimum tax payable at 0.5% of gross turnover less franked investment has been reduced to 0.25% for the two years of assessment ending between 1st January 2020 and 31st December 2021. This reduction in minimum tax rate will benefit medium-sized companies (with turnover between N25m and N100m) within the SMEs sector given that small companies (those with turnover not more than N25m) are already exempted from companies income tax (CIT).

Annual tax returns - All companies, irrespective of size were previously required to submit audited accounts when filing their annual tax returns. The FA 2020 has introduced an amendment which now empowers the FIRS to specify a simplified form of accounts, other than audited accounts, as part of the annual tax returns by SMEs.

Incentives for agricultural production - A definition of "primary agricultural production" has been introduced being primary crop production comprising raw and semi-processed crops of all kinds excluding intermediate or final processing of crops, primary livestock production consisting of production of live animals and their direct produce, primary forestry production and primary fishing production. This implies that companies involved in the agricultural sector but not in primary production, will no longer be eligible for the relevant incentives.

Filing of returns - The FIRS has now been empowered to make a request, by notice, for an alternative form of accounts to be included in a tax return instead of audited accounts for small and medium sized companies.

New Tertiary Education Trust Fund (Establishment, etc.) Act, 2011

Small companies that are exempted from companies income tax are now also specifically exempted from Tertiary Education Tax.

Amendments to Personal Income Tax Act

Individuals or persons in employment who earn monthly income not exceeding the national minimum wage (currently N30,000 per month) have been exempted from personal income tax. By implication, these individuals should no longer be subject to the monthly PAYE deduction. This amendment also protects many SMEs from PAYE compliance obligations in respect of their employees who earn monthly income of N30,000 or less.

Industrial Development (Income Tax Relief) Act

Small or medium-sized companies engaged in primary agricultural production are eligible for an initial tax-free period of four (4) years which may be extended for an additional two (2) years period subject to satisfactory performance.

Implications for Micro, Small and Medium-Sized Enterprises

Other key considerations for SMEs

- The VAT Act has been amended to clearly exclude land and building from the definition of taxable items. By implication, VAT should not be applicable on commercial or residential rent.
- Flight tickets sold by commercial airlines and agricultural equipment leased for agricultural purposes are now exempt from VAT.
- Every company, including a company exempted from tax, is required to maintain books of accounts in English language for a minimum period of six (6) years after the year of assessment in which the income relates. Failure to provide documents on request by the FIRS is liable to a penalty of N100,000 in the first month of default and N50,000 in each subsequent month the failure continues.
- Use of emails and other electronic means to communicate with FIRS regarding tax assessments and objections. A similar provision was introduced under the Personal Income Tax Act (PITA) by the FA 2019.
- Capital expenditure incurred on the development or acquisition of software or other electronic applications will now be qualifying expenditure eligible for capital allowance.
- Capital gains tax (CGT) on payments not exceeding N10 million made to staff as compensation for loss of employment is exempt from tax. Any excess above N10 million is taxable at the CGT rate of 10% to be deducted and remitted to the tax authority by the employer.
- A deadline of 30 June and 31 December of the relevant year has been introduced for self-assessment, payment and filing of CGT returns.
- Reduction in import duty rates and levy on various classes of motor vehicles as follows:
 - Tractors: reduction of import duty from 35% to 5%
 - Vehicles for transportation of goods: reduction of import duty from 35% to 10%
 - Cars: reduction of import levy from 35% to 5% (note, import levy does not apply to imported used cars). Import duty on new and used cars is retained at 35%.
 - Motor vehicles for transportation of more than 10 persons: reduction of import duty from 35% to 10%

Connecting the dots

With annual food inflation for December 2020 at 19.56%, the provision of tax incentives to SMEs involved in primary agricultural production is expected to boost food production and development of the sector which contributes a large percentage to national GDP. Also, the exemption of VAT on rent of agricultural equipment and the reduction in import duty on tractors and motor vehicles for transportation of goods will help to reduce production and distribution cost associated with agricultural produce.

In view of the recent changes introduced by the Companies and Allied Matters Act (CAMA) 2020 which exempts small companies from preparation of audited accounts, the amendment to CITA which empowers the FIRS to specify alternative forms of account, other than audited accounts, is designed to align the provisions of both laws regarding the requirement for audited accounts by small companies. It is expected that this amendment will facilitate the ease of doing business and compliance cost reduction for MSMEs.

Given the various incentives available to small companies, it is expected that many informal businesses and unincorporated entities will formalise their businesses. This is further strengthened by the new provisions of CAMA 2020 which allows a single shareholder to form a company, in addition to other administrative exemptions such as annual general meetings, appointment of company secretary and the use of a company seal.

Takeaways

In order to develop the activities of MSMEs and promote their competitiveness, including readiness to leverage potential opportunities under the Africa Continental Free Trade Area Agreement, there is a need for a more coordinated approach to the design, development and implementation of policies targeted at the sector across all levels of government. Beyond granting incentives, there should be deliberate and sustained efforts to address the challenges and impediments facing SMEs including multiplicity of taxes, complex regulations, access to credit and capacity building.

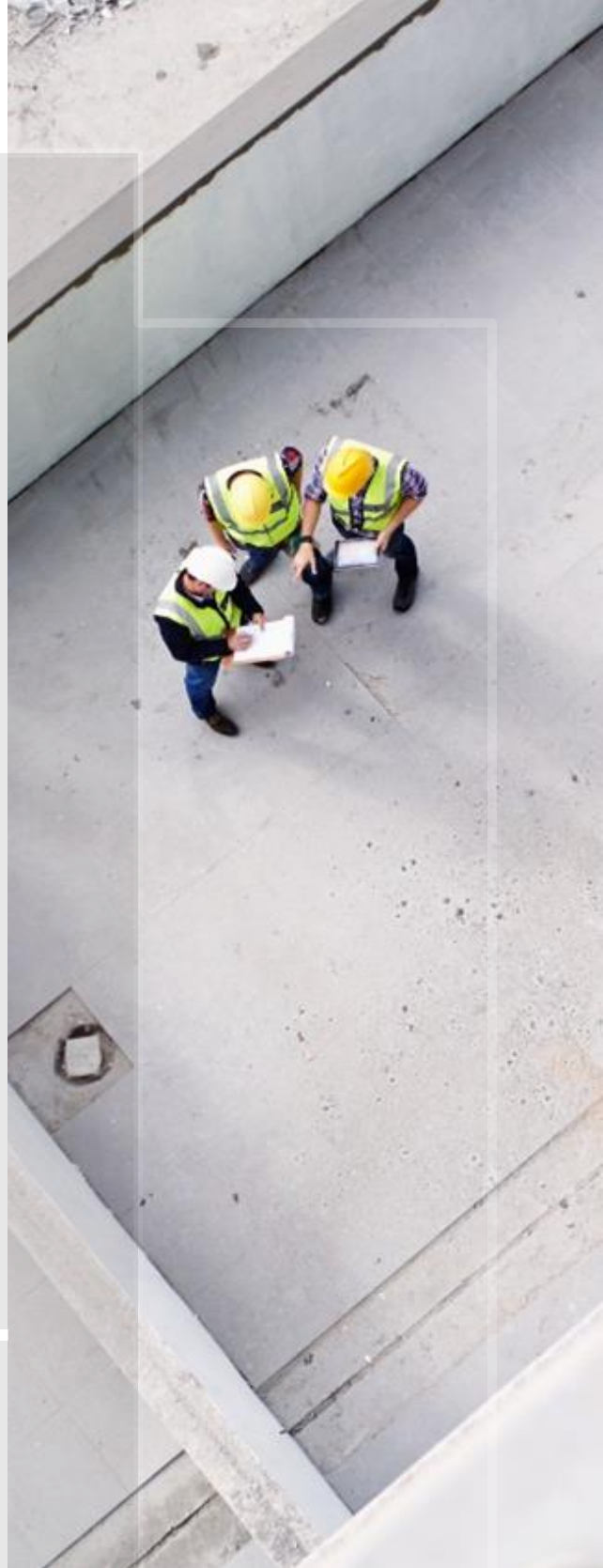




Implications for the Construction and Real Estate Industry



09



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Implications for the Construction and Real Estate Industry

Background

Like many industries, the construction and real estate sector has been hard hit by the COVID-19 pandemic. The construction sector experienced a slower growth rate of 35.5% in Q3 2020, a decline of 13.3% from the 48.8% growth rate recorded in Q3 2019 while the real estate sector experienced a negative growth of -8.06% in Q3 2020 compared to 3.71% in Q3 2019 indicating a decline of 11.77% year-on-year.

The Nigerian government has signalled its interest to develop the housing sector through the "Nigeria Economic Sustainability Plan" (NESP). The government intends to build about 300,000 homes under a Mass Housing Programme across the FCT and the 36 states of the federation. This is expected to facilitate the growth of the sector over the target period.



A deep dive of FA 2020 changes

The Finance Act 2020 introduced several changes that will affect the construction and real estate sector. We have analysed these changes below.

The definition of “goods” and “services” for VAT purposes

The FA 2020 has replaced the definition of “goods” and “services” introduced by the FA 2019. Historically, there have been inconsistencies and ambiguities regarding the VAT status of real property transactions including acquisitions, transfers or lease.

While the FA 2020 seeks to clarify the scope and coverage of transactions that are liable to VAT, there are still areas of uncertainties in the law. For instance, interest in Land or Building is stated as VAT exempt, but is not specifically stated whether the exemption covers the lease of real property.

Time of supply of goods & service for the purpose of VAT

Generally, the FA 2020 defines the time of supply for VAT as the earlier of when an invoice or receipt is issued by the supplier, or when payment/consideration is due to or received by the supplier.

Specifically, the Act clarifies that in relation to general construction activities entered into by an agreement or law requiring payment to be made based on percentage of completion, the time of supply will be the earlier of when payment is due, or received, or when an invoice is issued upon the successful completion of a milestone.

The time of supply provision could impact the applicable VAT rate in the event of a change. However, VAT payable will continue to be on cash basis as introduced by the FA 2019 i.e when the invoice is settled. Often the timing of invoice payment may not coincide with the time of supply. As such, construction companies need to have robust systems to track and reconcile the VAT point, payment, returns and accounting.

COVID-19 tax measure

The minimum tax rate payable by companies has been reduced from 0.5% to 0.25% of turnover for the two years of assessment ending 1 January 2020 to 31 December 2021. While this is generally a welcome development, it is not expected to have a material impact on construction companies given that they generally suffer a higher rate on their turnover by way of withholding tax.

COVID-19 tax measure

Given the low margin in the construction industry, deduction of withholding tax on turnover often results in perpetual tax refund position. Section 50 of FA 2020 introduced new subsections to replace existing section 23(4-6) of CITA. The amendment provides a legal framework for the Accountant-General of the Federation to open dedicated accounts for each tax type and money to be set aside based on an annual budget prepared by the FIRS and approved by the National Assembly for the timely payment of tax refunds. It is expected that this amendment will facilitate the process of obtaining tax refunds from the FIRS.

Implications for the Construction and Real Estate Industry

Further clarifications regarding taxation of Real Estate Investment Companies (REICs)

The FA 2019 introduced the exemption of dividend and rental income earned by a REIC from companies income tax (CIT), provided that a minimum of 75% of the dividend or rent is distributed within 12 months of the end of the financial year in which the income was earned. The FA 2019 further provided that any undistributed dividend and rental income after 12 months would be subject to tax.

This implies that even though a REIC may have met the minimum distribution requirement, it will still be taxed on its undistributed dividend or rental income. The FA 2020 has now addressed this problem by clarifying that the full dividend and rental income of a REIC will be exempt from CIT if at least 75% is distributed within 12 months after the year-end in which the income was earned.

Connecting the dots

An issue that is yet to be addressed is how to demonstrate compliance with the minimum distribution of 75% within 12 months when filing CIT returns that are due within 6 months after the financial year-end date. One way to resolve this could be for the FIRS to consider all REICs as exempted from CIT in respect of dividends and rents earned in a basis period within 12 months of the due date for filing returns with appropriate adjustments made in the subsequent year of assessment. Beyond the exemption for dividends and rental income, profits from disposal of properties developed or held by REICs should be specifically exempted from CIT in the hands of the REIC to make the structure truly tax transparent.

Nigeria is in urgent need of infrastructure and affordable housing to address the huge and growing supply deficit in the sector. Solving these challenges will require deliberate and sustained investment friendly policies, favourable tax regime, land administration reforms, among others.

In many jurisdictions, largely driven by the tax advantages of qualifying as a REIT or REIC, the scope continues to widen to cover an ever broader range of physical assets such as cell towers, billboards, golf courses, business storage, data centers, and telecom infrastructure, among others. This development has had a significant impact on the REITs market and, in fact, in a very short period of time have become some of the largest REITs by equity market capitalisation representing non-traditional asset classes.

Takeaways

Some of the new tax changes are geared towards providing a cushion to taxpayers due to the negative impact of COVID-19 and to encourage investments in the real estate and infrastructure sector.

Critical to the real estate and the infrastructure sector value chain is the construction industry. To complement the reduction of WHT rate from 5% to 2.5% introduced by the FA 2019, the amendments in the FA 2020 aimed at improving tax refunds will go a long way in supporting the growth of construction companies if properly implemented.





Implications for the Public Sector



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Implications for the Public Sector

Background

The outbreak of the Covid-19 pandemic and the aftermath of #EndSARS protest in 2020 left the economy in a bad shape as business operations and government activities were impacted. Government had to deal with unplanned expenditures in order to stimulate the economy and rolled out various palliatives to support households and businesses. As these events were unanticipated, making funds available to stabilise the economy afterwards required an Appropriation (Repeal and Amendment) Act 2020.

The need for more prudence in public spending, better accountability in mobilisation of funds and improving tax collection are some of key changes in the Finance Act 2020. Specifically, the Act introduces amendments to the Fiscal Responsibility Act (FRA) to permit expenditure overrun in case of emergencies such as a pandemic or threat to public security. The Finance Act also makes amendment to the Public Procurement Act (PPA) which clarifies the scope and coverage of the Act and seeks to improve the public sector procurement processes.



Fiscal Responsibility Act

Aggregate government expenditure in a fiscal year may exceed the approved budget in the event of a pandemic, natural disaster, war, imminent war or any act that threatens public safety, public security or the federation's existence. Prior to this amendment, any spending above the approved budget requires a supplementary budget or request for virement through the National Assembly.

The FA 2020 has also introduced a limit of cost to revenue ratio at 50% (previously no specific limit) for government owned entities or such other ratio as the Finance Minister via a Gazette upon the approval of the National Assembly. In addition, government corporations are required to remit the balance of their operating surplus to the Consolidated Revenue Fund of the Federation on a quarterly basis. Remittance of operating surplus was previously to be done not later than one month after the deadline for publishing annual accounts.

With these changes, each Corporation would now require the approval of the Minister before reporting a cost to revenue ratio above the specified threshold.

Public Procurement Act (PPA)

The Act expands the definition of "contracts" by specifying parties to a procurement contract as the procuring entity and a consultant, supplier or contractor. This definition seeks to capture all forms of procurement of services, goods and works by the public sector since the old definition was generic and its applicability to certain types of contracts could be misconstrued.

There is clarity on the government establishments that are subject to the PPA as this was vaguely defined before which resulted in speculations on procurements intended under the PPA. Also, the old phrase "public body" was often interpreted to cover only MDAs but not the other arms of government. The amendment has clarified the scope of the PPA to include the Judiciary, National Assembly, National Defence and the National Security Agencies. This implies that all procurements by all arms of government must comply with established procurement processes under the PPA.

Open competitive tendering

Prior to the amendment of this act, the procuring entity accounting office did not have the right to purchase or approve a contract without subjecting it to an open bid. The Finance Act now gives the accounting officer the right to purchase or approve contracts without open competitive tendering provided the value does not exceed the threshold set by the Bureau and approved by the Council. The Act also provides for other procurement options which can now be applied, conditional on obtaining the approval of the Bureau, unlike previously where procurement can only be conducted by open competitive bidding which led to unnecessary bureaucracy in some cases.

Implications for the Public Sector

Tender boards

The Act now provides for the creation of new Tenders Boards due to the extension of the Act to the other arms of government. The National Assembly would now have a tender board which would be chaired by the Clerk of the National Assembly and the National Judicial Council Tender board to be chaired by Chief of Justice of Nigeria, or his representative.

Bid submission period

Previously, the invitation for the submission of bids was within 6 weeks irrespective of the contract threshold. Under the new law, the period for bid invitations is 4 weeks for contracts within the thresholds of the Parastatals and Ministerial Tender's Boards, and not more than 6 weeks for contracts above the threshold. Also, bids can now be submitted electronically. These changes are expected to improve transparency and efficiency in public sector procurement processes.

Bid opening

FA 2020 now makes it necessary for the legal officer or other relevant officers of the procuring entity to be present in a bid opening exercise. This was not a requirement in the past.

Mobilisation fee

The Act increases the mobilization fee percentage from 15% to 30%. For funds to be disbursed above the set threshold for any procuring entity, the request for payment has to be accompanied by a "Certificate of No Objection" to the award of contract duly issued by the Bureau. The increase in mobilisation fee would provide more liquidity for contractors and improve the speed of contract execution.

Sundry amendments impacting FIRS and NIPOST

The Act expands the powers of the Federal Inland Revenue Service (FIRS) to administer matters relating to taxes and arrangements entered into with other countries. FIRS can also deploy technology to automate the tax administration process which includes tax assessment and information gathering. To ensure confidentiality, the Act stipulates imprisonment and/or a fine of N1 million for unlawful disclosure of taxpayers information by tax officers.

The Act also requires FIRS to utilise adhesive stamps produced by NIPOST for denoting duty on documents. Also, the stamp duty on electronic money transfer has been designated as Electronic Money Transfer levy. The revenue will be shared 15% to the federal government and FCT; and 85% to states. Under section 163 of the Constitution, net revenue from stamp duty collected by the federal government is to be shared to states based on derivation. This amendment may fuel the ongoing debate about restructuring and fiscal federalism.

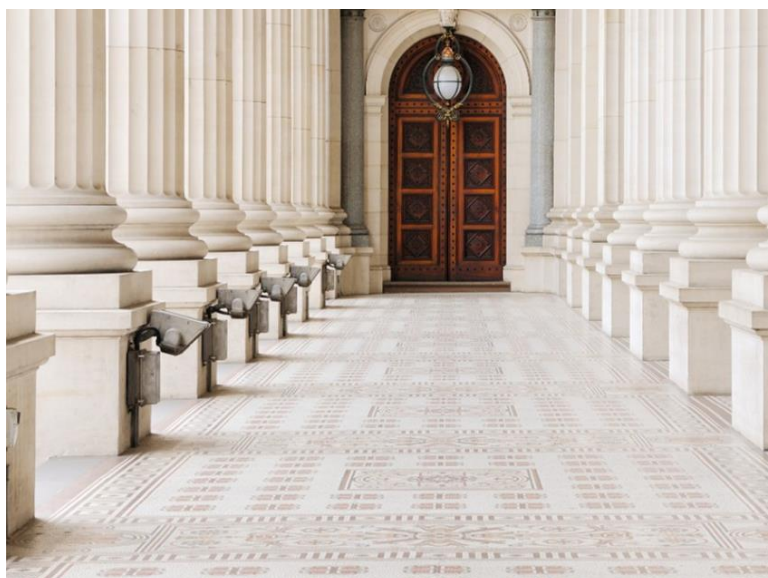
A new requirement to open separate refund accounts for each tax type has also been introduced while the Tax Appeal Tribunal may now hold its hearings virtually.

Establishment of the Crisis Intervention Fund (CIF) and the Unclaimed Funds Trust Fund (UFTF)

The Finance Act establishes a CIF of N500 billion or more to be funded from the Consolidated Revenue Fund (CRF) and Special Accounts.

The UFTF has been created as a sub fund under the CIF to be managed by the Debt Management Office (DMO) and jointly operated by the DMO, Central Bank of Nigeria and the Securities and Exchange Commission. It will be funded by unclaimed dividends and unutilised deposits in dormant bank accounts which remain unclaimed for a period 6 years or more from the date of dividend declaration or domiciliation of the fund in the bank. The Act exempts public sector bank accounts from this requirement.

The UFTF will be an additional source of fund available to the government although it will be deemed as a debt repayable with interest to the owners.



Implications for the Public Sector

Takeaways

Many of the changes introduced are targeted at ensuring fiscal responsibility by government and availability of funds to meet government expenditures. It is expected that the changes, if diligently implemented, should foster adherence to due process, reduced red-tape and improved transparency in government. In particular, the amendments to the PPA will serve as a precedent which State Governments can adopt and incorporate in their respective Public Procurement Laws.

The new cost to revenue ratio threshold is expected to promote expenditure efficiency but could also lead to aggressive revenue drive which may result in the corporations shifting focus from delivering public service.

While it appears that the UFTF is well intended, government must continue to engage with key stakeholders to seek their input and make necessary modifications in order to gain wider buy-in and public confidence.





Implications for aviation, shipping and road transportation



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Implications for aviation, shipping and road transportation

Background

Nigeria's transportation infrastructure spans over 195,000km of road, 6 international airports and over 20 domestic airports, 6 seaports, and a growing rail network. Despite the importance of transportation to all sectors of the economy, the industry has suffered from lack of a robust policy framework, inadequate investment and poor maintenance over the past few decades.

Year 2020 was quite challenging for the industry as a result of the Covid-19 induced economic challenges including lockdowns, border closure and various travel restrictions. It is projected that the industry will start to recover in 2021 however the outlook remains clouded by Covid-19 uncertainties.



Summary of Finance Act changes

Exemption of commercial aircrafts and flight tickets from VAT

The Act introduces a specific exemption for commercial aircrafts, commercial aircraft engines, commercial aircraft spare parts and airline tickets issued and sold by commercial airlines registered in Nigeria from VAT. This addresses the concern of the industry especially local airlines regarding the impact of various taxes and levies on the industry. In addition, the exemption of flight tickets is expected to help improve margins for the operators, reduce the cost of domestic air transportation and improve passenger demands.

Exemption of aircraft parts and components from customs duties

The Finance Act 2020 amends the second schedule of Customs and Excise Tariff Act (CETA) to exempt importation of aircrafts, engines, spare parts and components whether purchased or leased by commercial airlines registered in Nigeria. This is expected to lower the cost of doing business for commercial aircraft operators and encourage investments in the sector. While the import duty exemption is only applicable to airlines registered in Nigeria, the VAT exemption for the items is not specifically restricted to airlines registered in Nigeria.

Imposition of capital gains tax on certain ships and aircrafts

The Finance Act 2020 has amended section 24(f) CGT Act to limit the tax exemption on any chargeable gains on the disposal of a ship or aircraft to only those used in international traffic. The intention of this amendment is to impose CGT on the disposal of ships and aircrafts operating within Nigeria.

Reduction in import duty on motor vehicles of various classes

The Act provides for the reduction of import duties or levies on motor vehicles as follows:

1. Tractors - reduction of import duty from 35% to 5%;
2. Motor vehicles for transport of more than 10 persons - reduction of duty from 35% to 10%;
3. Cars - reduction of import levy from 35% to 5%; and
4. Motor vehicles for the transport of goods - reduction of duty from 35% to 10%.

The reduction of import tariffs is designed to cushion the impact of Covid-19 and fuel subsidy removal on the transportation sector and by implication the transportation cost to individuals and businesses. It is also expected that a moderate import tariff regime will discourage smuggling and improve government revenue.

Implications for aviation, shipping and road transportation

International shipping and airlines to be taxed at 30% on non-freight income

The international shipping industry has had a historical dispute with the FIRS on so-called 'non-freight income'. The industry took the view that Section 14 is a specific provision that imposed CIT on a foreign company carrying on the business of transport by sea or air. On the basis that the section specifically imposes CIT only on outbound transport, any other income earned should either be exempted from CIT or taxed as incidental income at the lower rate applicable to outbound freight income.

The FIRS on the other hand takes the view that the non-freight income is accessible to CIT at the standard rate of 30% in like manner as any other business, whether resident in Nigeria or not.

The new provision introduced by the Finance Act now clearly excludes non-freight income (i.e. income from leases, containers, non-freight operations or any other incidental income) from the provisions of section 14 of CITA. This implies that such income will be taxable under Section 9 of CITA.

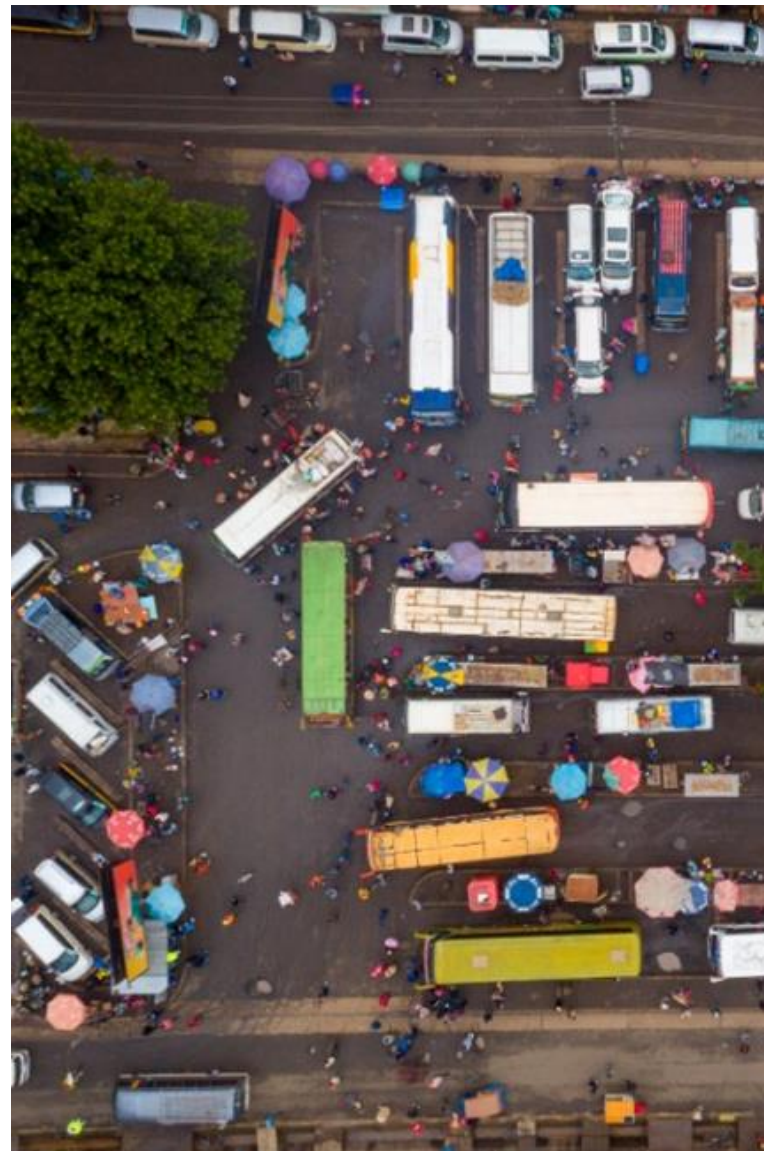
Connecting the dots

There is a need to assess the impact of the recent amendments on other policies of government especially the Nigerian Automotive Industry Development Plan introduced in 2013. The impact of the changes should be such that balances the need to cushion the impact of rising cost of transportation, fuel subsidy removal, Covid-19 induced downturn in the sector while sustaining the investment in local production of vehicles and domestication of the production value chain. This is critical in view of the take-off of AfCFTA and the need for Nigeria to position itself as a manufacturing hub within the continent. Beyond import tariffs, other complementary policies are needed to sustain demand for current production capacity while supporting the industry to scale and enhance quality at affordable prices in the near future.

Takeaways

Generally, the intention of the changes targeted at this industry are aimed at incentivising operators by reducing their tax burdens and clarifying some existing grey areas. It is expected that the changes introduced by the Act will lower the cost of doing business for operators and attract investment in the different sub-sectors of the industry.

However, ongoing reviews, stakeholder engagement and further considerations are required to ensure that the incentives and reliefs targeted at this industry are robust to achieve the desired impact.





Implications for individuals and employers of labour



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Implications for individuals and employers of labour

Background

The President of Nigeria assented to the Finance Bill 2020 on 31 December 2020. The Act which takes effect from 1 January 2021 introduced amendments to several tax and fiscal laws including the Personal Income Tax Act (PITA) and the Capital Gains Tax Act (CGTA). Broadly, the changes provide clarity to some previously grey areas, address areas of possible non taxation or double taxation and introduced an income exempt category.

We highlight the changes and their implications for individuals and employers in this alert.



Redefinition of Gross Income

Section 33(2) of PITA has been amended as follows;

“For the purposes of this Section, “gross income” means income from all sources less all non-taxable income, income on which no further tax is payable, tax-exempt items listed in paragraph (2) of the sixth schedule and all allowable business expenses and capital allowances.”

Implications: Gross income is the basis for calculating the Consolidated Relief Allowance (CRA); the higher of ₦200,000 or 1% of Gross Income plus 20% of Gross Income. The new definition means tax exempt items should now be deducted from gross emolument before computing the CRA.

This means employees will no longer enjoy the additional 20% relief previously claimable on the portion of their income that relates to National Housing Fund, pension contribution, and other tax exempt items. The reduction in CRA would result in higher effective tax rate and lower disposable income. Employers need to update their payroll templates or applications to ensure compliance.

Tax exemption for minimum wage earners

Section 37 and para 33 of the Third Schedule of PITA have been amended to exempt from personal income tax, any persons earning the national minimum wage or less from any employment. Section 108 defines this as the extant national Minimum Wage pursuant to National Minimum Wage Act.

Implications: Employees who earn not more than the National Minimum Wage (currently ₦30,000) are no longer liable to tax or deduction of monthly PAYE.

Tax exemption threshold for compensation for loss of employment

Section 36(2) of CGTA is amended to state that sums obtained by way of compensation for loss of office, up to a maximum of ₦10m, shall not be chargeable gains subject to tax under this Act. Provided that any sum in excess of ₦10m shall not be so exempt but the excess amount shall be chargeable gains and subject to tax accordingly.

Sections 36(3) &(4) further state that any person who pays compensation for loss of office to individual is required, at the point of payment of such compensation, to deduct and remit tax to the relevant tax authority in line with the Pay As You Earn (PAYE) Regulation.

Implications: Any payment to an employee as compensation for loss of employment up to N10m is exempted from tax. However, any excess above N10m is taxable at the GCT rate of 10%. An employer paying such compensation is required to deduct the CGT and remit to the relevant tax authority within the time specified in the PAYE regulations (being the 10th day of the month following payment). Employers will also be required to report such payments during the annual tax filing.

Significant Economic Presence

Section 6(A) of PITA introduces the Significant Economic Presence (SEP) rules to the taxation of non-resident individuals, executors or trustees carrying on a trade or business comprising Technical, Professional Management or Consultancy (TPMC) services to persons resident in Nigeria. The Minister of Finance may by order define what constitutes SEP for this purpose.

Implications for individuals and employers of labour

Implications: Foreign persons earning business profits from Nigeria are taxed under Section 6 of PITA once a fixed base/taxable presence is created subject to existing treaties.

Section 6A introduces another basis for taxing such profits that previously escape a fixed base. In such cases, the gains or profit attributable to the activities will now be deemed to be derived from Nigeria and subject to withholding tax (mostly 5% for individuals) as final tax.

This may lead to double taxation on the profits even for treaty beneficiaries. While the constitution provides that tax treaties should be respected in Nigeria, and the Double Tax Agreements (DTAs) generally contain domestic law override provision, the tax authority may seek to apply section 38 of the PITA which provides as a condition, that a treaty only comes to effect if it is **expedient** that the agreement has effect.

The overall implication would be double taxation except a relief is available in the country of residence of the taxpayer.

Life assurance as an allowable deduction

Section 33(3) reinstates the relief by way of deduction for the premium paid by an individual to an insurance company in respect of insurance for his life or that of his spouse or contract of deferred annuity for his own life or that of his spouse in the preceding year of assessment.

Implications: This provision was previously removed by the Finance Act 2019, perhaps in error, but has now been reinstated.

Individuals can now continue to claim tax reliefs on premium payments on their life assurance or that of their spouse.

Pension contributions

Section 20(1g) of PITA has been amended to specifically limit tax relief for pension contributions only to schemes, provident or retirement benefits fund that are recognised under the Pension Reform Act (PRA) 2014.

Implications: Any pension contribution made into a scheme not recognised under the PRA 2014 will not qualify for tax deduction. Individuals who contribute to foreign schemes will not be able to claim a deduction in Nigeria for such contributions. Employers should ensure that only contributions to approved pension schemes under the PRA are treated as an allowable deduction on payroll.

Commencement and cessation rules

Sections 24 & 25 of PITA have revised the basis of taxation for individuals during commencement or cessation of business. The amendment effectively eliminates possible double taxation during commencement or non taxation during cessation. Rather, taxation will be based on the relevant accounting period of such business without any gap or overlap.

Implications: The revision of commencement and cessation rules will prevent possible double taxation which previously applied to a new enterprise on its profits of at least 12 months within the first 3 years of assessment. Also, the possibility of any accounting period escaping taxation during cessation has been eliminated.

Takeaways

The Finance Act 2020 has clarified some grey areas regarding the taxation of individuals, introduced some changes to broaden the tax net, cut back on generous personal reliefs while granting exemption from tax to the most vulnerable employees by exempting minimum wage from tax.

Employers will need to review and update their payroll systems, assess the impact of the new provisions on their employees, payroll compliance and reporting obligations. Any potential impact should be communicated to employees in advance.

Non resident individuals who provide TPMC services should consider if they will create an SEP under the new rules subject to any clarification by the Finance Minister.



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