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Nigeria's Finance Act 2021

Insights series and sector analysis



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Overview and general implications

01



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Overview and general implications

Economic context



After witnessing a COVID-19 induced recession in Q3 2020, the Nigerian economy rebounded quickly in Q4 2020 growing by 0.11%. The recovery momentum was sustained in 2021 despite the rise in covid-19 cases and the emergence of new variants. According to the National Bureau of Statistics (NBS), the Nigerian economy expanded by 4.03% year-on-year in Q3 2021 and 11.07% on a quarter-on-quarter basis. The quick rebound in GDP was attributed to intervention programs by the Federal government, the Central Bank of Nigeria (CBN), and the re-opening of the economy and the base year effect.

The non-oil sector recorded a growth of 5.4% in Q3 2021. The growth in the non-oil sector was largely attributed to improved economic activities which was evident in the growth of major contributors to the GDP such as agriculture (1.2%), Trade (11.9%), Information and Communication (9.7%), and Manufacturing (4.3%). Together, these four sectors accounted for about 68% of total GDP in Q3 2021.

Meanwhile, the oil-sector continued to face challenges in Q3 2021 as it contracted by -10.7%, the third consecutive quarterly decline in 2021. The gain in oil price recovery which averaged US\$67.5 per barrel in the last nine months in 2021 was wiped off by the decline in crude oil production. By Q3 2021, production averaged 1.57 million barrels per day (mbpd), a significant decline compared to the average pre-pandemic and pandemic levels of 2.01 mbpd and 1.85 mbpd respectively.

While most economies are battling with rising inflation mainly due to aggressive cash injection by government and disruption in global supply chains, among others, Nigeria's headline inflation rate sustained its continuous deceleration in November 2021 to 15.44% after reaching a 35-month high of 18.17% in March 2021. The sustained decline in inflation rate and moderate GDP growth rate puts less pressure on the CBN to tighten money supply.

Given the above, a key priority for the Federal Government is introduction of policies that will raise its revenue to address rising debt servicing costs and budget deficits while stabilising the economy.

Overview and general implications

Highlights of the Finance Act 2021

The Finance Act 2021 ("FA 2021") was passed by the National Assembly and signed into law by the President on 31 December 2021. The FA 2021 which comes into effect from 1 January 2022 complements the 2022 Federal Government's Budget of Economic Growth and Sustainability. Below are some of the key changes.

Capital Gains Tax (CGT)

CGT on sale of shares

The FA 2021 amends the CGT Act to impose CGT at 10% on gains from the disposal of shares worth N100m or above in any 12 consecutive months, except to the extent that the proceeds are reinvested in the shares of any Nigerian company. CGT will accrue proportionately on the portion of sales proceeds not reinvested. However, CGT will not apply on shares transferred between an approved Borrower and Lender in a Regulated Securities Lending Transaction.

Insights

This amendment seems to be targeted at institutional and high networth investors given the threshold. However, taken with other recent changes such as the expiration of the 10-Year corporate income tax exemption order on government and corporate bonds, and the previously expired VAT exemption Order on commissions on stock market transactions, the government seems to be rolling back some of the incentives available in the capital market. This could increase the cost of raising capital especially for the private sector.

Companies Income Tax Act (CITA)

Educational institutions now liable to CIT

The FA 2021 deletes the longstanding income tax exemption enjoyed by companies engaged in educational activities. Consequently, the profits of such companies are now liable to tax regardless of whether or not their activities are of a public character. The applicable tax rate will depend on whether an educational company is classified as a medium or large company, subject to CIT at 20% or 30% respectively. Educational institutions that are classified as small companies will remain tax exempt.¹ Also, educational institutions that are set up as "not-for-profits" may continue to enjoy tax exemption in line with other provisions of the law.

Export profits exemption

Prior to the FA 2021, CITA generally exempted profits generated by Nigerian companies on goods exported from Nigeria, if the export proceeds are reinvested to purchase raw materials, equipment and spare parts. With the enactment of the Petroleum Industry Act 2021 (PIA 2021), companies involved in Upstream operations which were subject to tax under the Petroleum Profit Tax are now taxable under CITA. To avoid granting exemption on the export of oil and gas, the FA 2021 modifies the export profits exemption to exclude companies engaged in Upstream, Midstream and Downstream petroleum operations.

Export Processing and Free Trade Zones

The FA 2021 reintroduces the tax exemption for the profits of companies established and operating within an export processing zone (EPZ) or a free trade zone (FTZ) in Nigeria. This exemption was inadvertently deleted by the Finance Act 2019. Consequently, this amendment reaffirms the legal basis in CITA for the income tax exemption of the profits of EPZ and FTZ provided that requisite conditions are met.

Powers of the FIRS to assess income tax on the turnover of foreign digital companies

CITA empowers the FIRS to assess companies to tax on a "fair and reasonable" percentage of their turnover, if such businesses have low or no assessable profits which, in the opinion of the FIRS, are less than expected. This is often referred to as the "deemed profits" basis. In practice, a 20% margin is deemed on turnover and subjected to tax at 30% (resulting in an effective rate of 6% of turnover). The recent amendment now extends the deemed profits tax provision to foreign companies having Digital Significant Economic Presence (SEPs) in Nigeria.

Claim of capital allowances

The FA 2021 restricts the claim of capital allowances to the portion of qualifying assets used for generating taxable income. Capital allowance on assets exclusively used to generate tax-exempt income will not be claimable, and capital allowance on assets that are partially used for generating taxable income will be prorated except where the proportion of non-taxable income is less than 20% of the company's total income.

1. Large companies - generate annual revenues of N100m and above
Medium companies - generate annual revenues between N25m and N100m
Small companies - generate annual revenues less than N25m

Overview and general implications

For small and medium companies, the FA provides that capital allowances for each year, together with any unabsorbed capital allowances brought forward, will be deemed to be utilised. However, such companies can carry forward the tax residue (tax written down values) of qualifying assets to subsequent periods when it may become taxable. Pioneer Companies are exempt from these amendments during their pioneer period.

Reduction in Minimum Tax rate

The reduction of the minimum tax rate from 0.5% to 0.25% of turnover (less franked investment income) will apply to any two consecutive accounting periods between 1 January 2019 and 31 December 2021 as may be chosen by the taxpayer. This addresses previous ambiguities relating to the period covered by this incentive. However, the exemption will only be granted where the relevant returns are filed before the filing due dates.

Insights

While the FIRS may assess tax on a non-resident digital company using the "deemed profits" basis, such companies nonetheless are able to pay their tax on actual profits basis where the level of profit can be substantiated. There may also be opportunities for affected companies to engage with the FIRS for a lower "fair and reasonable" rate for Digital SEPs, different from the 6% of turnover that has been used historically.

The requirement to deem all the capital allowances of small companies as utilised may put such companies in a worse situation than if they were not exempted from tax in the first place.

Customs, Excise Tariff, etc (Consolidation) Act

Excise on non-alcoholic beverages

The FA 2021 introduces excise duties at N10 per litre on non-alcoholic, carbonated and sweetened beverages.

Insights

Based on the ordinary reading of the amendment, it appears that the 3 conditions: "non-alcoholic, carbonated and sweetened" must all be met for excise duties to apply. However, the intention of the federal government is very likely to impose excise on products which meet any of the stated conditions separately. The tax is likely to result in up to 5% increase in selling prices of lower-end products.

Federal Inland Revenue Service (Establishment) Act

Deployment of technology for tax administration

The FIRS can now deploy third-party technology (previously limited to proprietary technology) to automate the tax administration process, including assessments and information gathering. The FA 2021 requires the FIRS to give 30 days' notice to taxpayers, with the FIRS reserving the right to withdraw or extend the notice if the taxpayer shows "good cause". There is now an administrative penalty of NGN25,000 for every day that the taxpayer fails to grant access to the FIRS.

FIRS' power to solely administer, assess, collect and enforce tax revenue of the Federal Government

The FIRS is the only agency of the federal government responsible for the administration, assessment, collection, accounting and enforcement of taxes and levies due to the Federation, the Federal Government and any of its agencies, except otherwise authorised. Contravention by any relevant officer(s) attracts a fine of NGN10m and/or imprisonment for a term not exceeding 5 years upon conviction.

Insights

While the provisions of the new law regarding the use of technology for information gathering seek to address the concerns of both the FIRS and taxpayers, it would be necessary to adopt a collaborative approach in order to facilitate a seamless implementation.

The clarification on the FIRS' responsibility for tax administration is a positive step expected to reduce indiscriminate multiple tax audits by different government agencies who had previously relied on omnibus provisions in their enabling legislation to perform tax administration related functions.

Personal Income Tax Act

Tax deduction for deferred annuity payments

The FA 2021 excludes from allowable deductions, premiums relating to contracts for a deferred annuity on a taxpayer's life or the life of his/her spouse. This amendment is expected to affect premiums paid after 1 January 2021.

Overview and general implications

Penalty increases

Banks are required to file quarterly (previously monthly) returns (not later than the 7th day of the following month) of all new customer registrations to the relevant tax authority. The penalty has been increased to N1m for each quarterly return not filed or with incomplete/incorrect information. Banks are also now liable to a steeper penalty of N1m when they fail to respond to any calls for information necessary to ascertain the income and tax payable by an individual.

Also, the general penalties for offences under PITA has been increased to NGN20,000 with NGN2,000 for each day of default in furnishing a return, statement or information or to keep required records.

Insights

Individual taxpayers are no longer able to obtain tax deductions for premiums relating to deferred annuity contracts, except those obtained under the provisions of the Pension Reform Act. This amendment underscores the need for taxpayers to obtain clear documentation in support of any life assurance policy they subscribe to.

Stamp Duties Act (SDA)

Electronic Money Transfer Levies (EMTL)

Subject to the approval of the National Assembly, the Minister for Finance is empowered to issue regulations relating to the auditing, accounting, allocation and distribution of arrears of relevant stamp duties and Electronic Money Transfer Levies (EMTL) collected between 2015 and 2019 fiscal years. It also provides that EMTL be distributed within 30 days of collection.

Tertiary Education Tax (TET)

Assessment and collection of Tax

TET payable by Nigerian companies has been increased from 2% to 2.5% of assessable profits. The FA 2021 also provides that TET is now due and payable within 30 days after an assessment from the FIRS, although in practice, most companies self-assess and settle their TET liabilities together with their CIT.

Value Added Tax Act

VAT registration by Non-Resident Companies (NRCs)

Pre-FA 2021, the literal reading of the VAT laws indicated that the obligation for NRCs to register for VAT and obtain a Taxpayers Identification Number (TIN) may be bypassed by appointing a Nigerian representative for compliance obligations. The VAT Act has been amended to make registration for tax and obtaining TIN compulsory even where a representative has been appointed by the NRC.

Collection of VAT on transactions with NRCs

With respect to supplies by NRCs to taxable persons in Nigeria, the FA 2021 empowers the FIRS to appoint any party to withhold or collect the relevant VAT, and remit to the FIRS. Prior to the FA 2021, the person appointed was able to only “withhold and remit”. This amendment therefore clarifies the powers of the FIRS and the responsibilities of the person appointed. Where such an appointed person makes supplies to taxable persons in Nigeria, the customer will not be required to withhold VAT from the appointed person except where such person appointed has failed to collect the tax.

Other changes

Companies engaged in upstream petroleum operations are required to comply with all VAT requirements regardless of their turnover.

Insights

The request for all NRCs that transact with Nigerian customers to register for VAT may pose a challenge of enforcement. It would have been more feasible for the registration requirement and primary responsibility for collection to be limited to NRCs that have a Digital SEP or some form of physical presence in Nigeria.

Nigerian Police Trust Fund (Establishment) Act (NPTF Act)

The NPTF Act was signed into law in June 2019, and establishes a fund, proceeds from which will be used to train police personnel and procure security machinery and equipment. The Act imposes a levy of 0.005% of the “net profit” of companies carrying on business in Nigeria. However, there was previously no clarity on the modalities for assessing and administering the levy.

Overview and general implications

The FA 2021 has now clarified that the FIRS will administer the levy, and that relevant provisions in CITA and the FIRSEA will apply in respect of administration, assessment, collection, and enforcement. Therefore, companies operating in Nigeria will be required to comply and pay the levy.

Insights

There are still some unanswered questions, such as whether the FIRS will seek to enforce collection of the levy from 2019 or prospectively; the lack of a definition of 'Net profit'; the forms to be used for filing; whether the levy will apply to non-resident companies, and so on. Also, the Act provides that the Fund is to operate for six years from commencement of the Act unless extended for any further period by the National Assembly. It is not clear whether the six years will count from 2019 when the law was enacted or 2022 when the administration of the tax came into effect.

National Agency for Science and Engineering Infrastructure Act (NASENI Act)

NASENI was established in 1992 under the NASENI Act to contribute to science and technology advancement in Nigeria. Pre-FA 2021, the Act imposed a levy of 0.25% of the turnover of commercial companies. However, there was no clarity on the modalities for administering the levy and it was not assessed in practice.

The FA 2021 now empowers the FIRS to collect the levy, and provides that the levy is now to be computed at 0.25% of the profit before tax (as against turnover) of commercial companies in the banking, mobile communication, ICT, aviation, maritime, and oil and gas sectors. Companies with annual turnovers below NGN100m are not liable.

Insights

Although the NASENI Act prescribes that the FIRS will collect the levy, it does not contain specific provisions such as penalties in the event of defaults. There are also concerns on the interplay with the National Information Technology Development Agency (NITDA) levy, as both agencies seem to have similar functions.

Takeaway

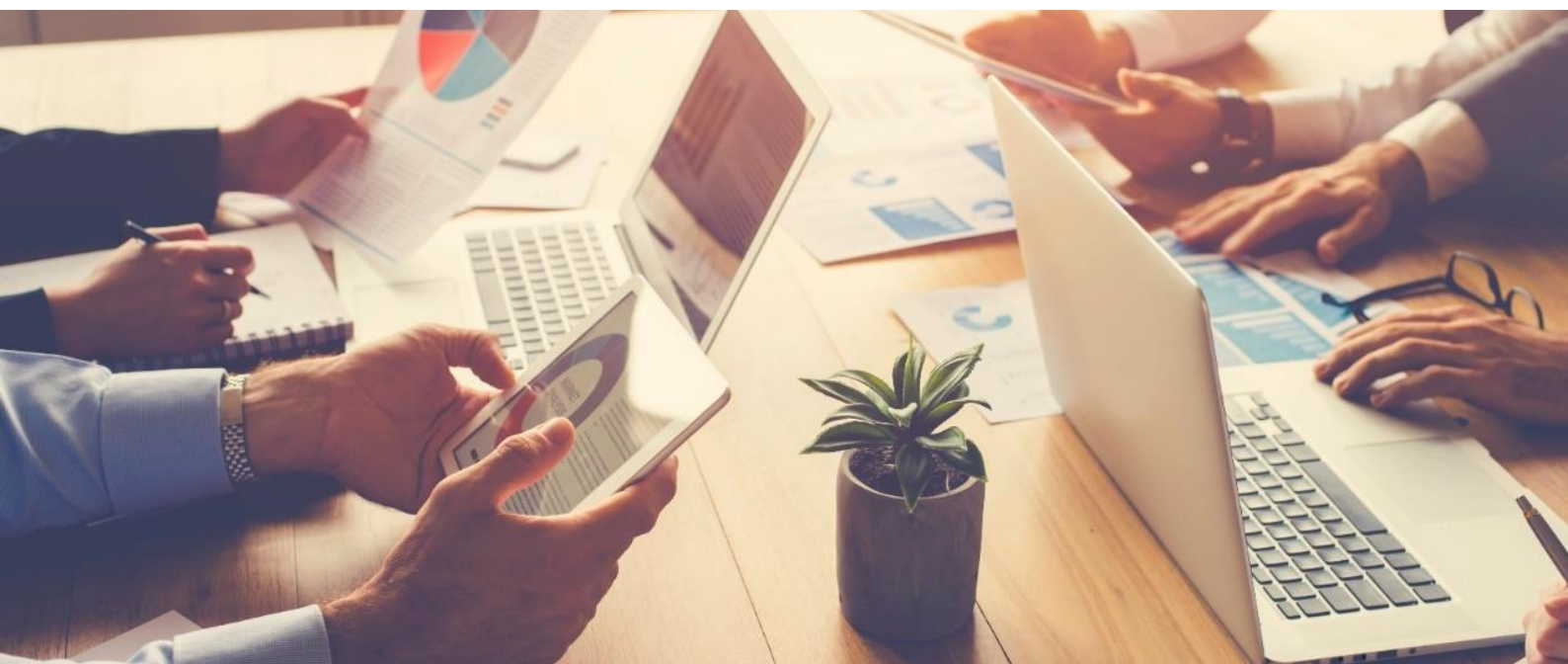
The FA 2021 continues the tax reform measures introduced by previous Finance Acts, and indicates the government's drive to increase tax revenue to continue to meet rising recurrent, capital and debt obligations. The changes also underscore the government's resolve to continue to adopt and leverage technology in tax administration.

It is expected that the government will continue to periodically assess and review the implications of some of the changes introduced, including engaging with key stakeholders to ensure that intended revenue and other broader objectives are met.



Banks, Insurance, Other financial institutions and Capital markets

02



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Implications for the Banks, Insurance, Other financial institutions and Capital markets

Overview

The financial services sector remained resilient through the third quarter of 2021. According to the National Bureau of Statistic (NBS), sector growth in Q3 2021 was 20.02% higher than the 3.6% recorded in the corresponding quarter of 2020. The contribution of the sector to the Gross Domestic Product (GDP) also increased by 3.16%.

The National Development Plan 2021 – 2025 acknowledges the critical role a robust domestic financial sector and capital market will play in the growth and development of the country.

The Nigerian insurance sector remains an important part of the financial system given its role in loss mitigation, risk management and business stability. The sector was however not spared from the disruptive effect of the COVID-19 pandemic in 2020. The sector was stuck in recession all through the pandemic period. By the end of 2020, the insurance sector contracted by -15.3% year-on-year. But by Q3 2021, the sector rebounded, posting a year-on-year growth rate of 5.1% compared to -18.7% recorded in Q3 2020. The sector is however yet to return to the pre COVID-19 pandemic levels.

In 2021, the Nigerian Stock Exchange (NSE), subsequent to the approvals of the Corporate Affairs Commission and Securities and Exchange Commission completed the demutualisation process.

The 2021 Finance Act introduced some changes which will affect the banking, insurance and other financial institutions. Significant among these changes are the following:

Key Changes introduced by the Finance Act 2021

Capital Gains Tax (CGT) on disposal of shares

The FA 2021 amends the CGT Act to impose tax at 10% on gains from the disposal of shares in a Nigerian company worth N100m or above in any 12 consecutive months, except to the extent that the proceeds are reinvested in the shares of any Nigerian company. CGT will accrue proportionately on the portion of sales proceeds not reinvested in the above manner. Regulated Securities Lending Transactions are exempt from CGT and so are government securities and gain on trading shares.

Minimum Tax

The FA 2021 harmonises the minimum tax provisions applicable to Insurance companies. Previously, insurance companies were subject to minimum tax based on section 16 and section 33 of the Companies Income Tax Act. With this change, insurance companies are subject to minimum tax solely based on section 33 of the CITA. Although the tax base for the minimum tax i.e gross premium for non-life insurance companies and gross income for life insurance companies are defined in section 16 of CITA.

The FA 2021 extended the coverage of the 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 two accounting periods by one year (to include the calendar year 2021). The reduced minimum tax rate includes periods between 1 January 2019 and 31 December 2021. Companies are expected to apply the reduced rate for any two years of assessment either from 1 January 2019 to 31 December 2020 or 1 January 2020 to 31 December 2021 as may be determined by the taxpayer.

Companies that have not filed their income tax returns or filed the tax returns late are not eligible for this incentive. This amendment provides a tax saving opportunity for affected companies. The harmonisation of the minimum tax provision for insurance companies also provides much needed fiscal equity in line with the National Tax Policy 2017.

Restriction on Capital Allowance claim

The FA 2021 restricts the claim of capital allowances to the portion of qualifying assets used for generating taxable profits. Capital allowance on assets exclusively used to generate tax-exempt profits will not be claimable, and capital allowance on assets that are partially used for generating taxable profits will be prorated. The restriction will only apply where the proportion of non-taxable income exceeds 20% of the company's total income. This restriction does not apply to companies who enjoy tax exemption under the pioneer incentive scheme in line with the Industrial Development (Income Tax Relief) Act (IDITRA).

This will have an impact on the financial sector that has historically earned significant tax exempt income. Although with the expiration of the Income Tax Exemption Order on Government bonds, treasury bills and corporate bonds on 1 January 2022, the tax-exempt income is expected to reduce.

Implications for the Banks, Insurance, Other financial institutions and Capital markets

This restriction in the claim of capital allowance could impair the incentives granted to the sector to stimulate economic activities e.g income tax exemption of investment income from policyholders' fund for life insurance companies, federal government bonds etc. This will also have a negative impact on the effective tax rate of the affected taxpayers who earn income that is exempt from Companies Income Tax but subject to Capital Gains Tax as well as small and medium companies that will lose their capital allowances.

Increased taxes i.e Tertiary Education Tax, National Agency for Science and Engineering Infrastructure Levy and Nigerian Police Trust Fund Levy and compliance obligations

The FA 2021 introduces changes to the Tertiary Education Tax Act, National Agency for Science and Engineering Infrastructure Act and the Nigerian Police Trust Fund (Establishment) Act that will increase the tax payable and compliance for the sector subject to certain exemptions. We have provided additional details below:

- Tertiary Education Tax – a 25% increase in the rate from 2% to 2.5%. This applies to all companies including the financial sector other than small companies. The amount paid is not tax deductible.
- National Agency for Science and Engineering Infrastructure Levy – 0.25% on the profit before tax of Banks with a turnover of above N100m. This levy does not apply to non-banks in the financial services sector. Contributions to the fund are tax deductible, based on the NASENI Act.
- Nigerian Police Trust Fund Levy – The levy which was introduced in 2019, however there was no clarity on the administration of the Act. FA 2021 has allocated this role to the Federal Inland Revenue Service. Returns will be filed in line with the provisions of the Companies Income Tax Act i.e. 6 months after the company's year end. The amount paid is not tax deductible.

This increases the effective tax rate of affected companies and their compliance obligations. It further adds to the myriad of multiple taxation in the sector given other earmark taxes e.g. National Information Technology Development Levy and industry specific compliance obligations i.e Common Report Standards, Electronic Money Transfer Levy etc.

Premium paid for Life assurance premiums

The FA 2021 excludes premiums relating to contracts for a deferred annuity on a taxpayer's life or the life of his/her spouse as tax deductible. This amendment is expected to affect premiums paid from 1 January 2022.

This change will make deferred annuity contracts less attractive to existing and potential policyholders.

Penalty for failure by Bankers to deliver quarterly returns

The FIRSEA requires every Bank to submit quarterly returns to the FIRS, providing information including names and addresses of individual and corporate customers whose transactions involve a minimum sum of NGN5m and NGN10m, respectively. The FA 2021 amendment increases the penalty for failure to comply with the above requirements to a flat penalty of NGN1m for each quarterly return not filed or with incomplete/incorrect information.

Also, PITA requires banks to file quarterly (previously monthly) returns, not later than the 7th day of the following month, of all new customer registrations to the relevant state tax authority. The penalty has been increased to NGN1m for each quarterly return not filed or with incomplete/incorrect information. Banks are also now liable to a steeper penalty of NGN1m for failure to respond to any calls for information necessary to ascertain the income and tax payable by an individual.

These will increase the cost of non-compliance for Banks in respect of submitting quarterly returns. To safeguard the financial information, tax officers are required to treat taxpayer information as confidential.



Implications for the Banks, Insurance, Other financial institutions and Capital markets

Other changes

- The definition of Real Estate Investment Company now includes a Real Estate Unit Trust for Companies Income Tax purposes. This will therefore apply to the activities of unit trusts established to invest in real estate properties as approved by the Securities and Exchange Commission (SEC).
- Withholding tax on interest earned from a unit trust will be treated as final tax. Only WHT on dividend is currently treated as final tax for local companies.
- Electronic Money Transfer Levy collected after the effective date of the FA 2021 are to be distributed within 30 days following the month of collection.
- The FA 2021 amends the Insurance Act by replacing the term "Paid up share capital" with "Capital requirement".

For existing companies, capital requirement includes the following:

- the excess of admissible assets over liabilities, less the amount of own shares held by the company, subordinated liabilities subject to approval by the Commission, and
- any other financial instrument as prescribed by the Commission,

For new companies, Capital requirement includes the following:

- Government bonds and Treasury bills
- Cash and Bank balances and
- Cash and cash equivalent.

It is expected that the regulators i.e National Insurance Commission and the Central Bank of Nigeria will issue regulations on how these provisions of the law will be implemented.

Takeaway

Majority of the changes are geared towards raising revenue for the government from elimination of the CGT exemption on sale of shares, increase in the TET rate, restriction of capital allowance claim and operationalising the NASENI and Police Trust Fund levies. It is expected that the CGT on sale of shares, even though regulated securities lending transactions are exempted, will have a major impact on the capital market.

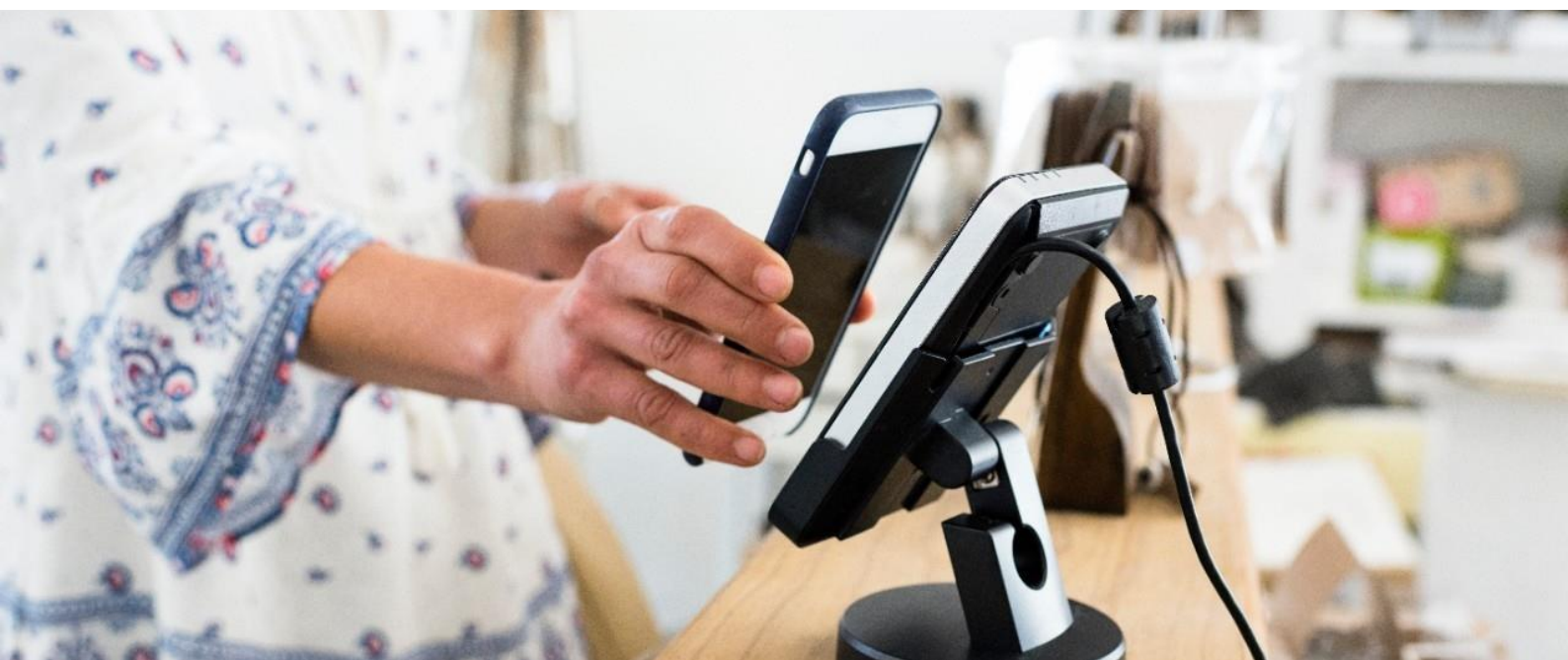
This is in addition to the expiration of the income tax exemption on financial assets i.e bonds (short and long term), application of VAT at 7.5% on commission arising from capital market transactions and the newly introduced SEC charges.

It is likely that the government will continue to focus on reforms designed to promote growth in the financial sector whilst looking for opportunities to raise sustainable tax revenue through expanding the tax base.



Non-Residents and the Digital Economy

03



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Implications for Non-Residents and the Digital Economy

Overview

Globally, the pandemic has accelerated the adoption of technology and the consumption of digital goods and services. As a result, the digital economy has seen significant growth in recent times and governments around the world are constantly seeking to tax the resulting revenues. The Information and Communication sector, bolstered by activities in the telecommunication space, remains one of the sectors with a positive growth trajectory. By the end of Q3 2021, the ICT sector grew by about 9.7% compared to 5.6% and 14.6% in Q2 2021 and Q3 2020 respectively.

Over the last 2 years, there have been a lot of changes and introduction of new laws and regulations taxing the activities of non-residents and the profits generated from digital activities in Nigeria. The FA 2021 introduces additional changes seeking to enhance the collection and administration of digital taxes in Nigeria.

VAT

VAT registration by Non-Resident Companies (NRCs)

All non-residents to which this requirement applies are to register for VAT and obtain a TIN, after which a representative may be appointed to provide support with compliance obligations.

Collection of VAT on transactions with NRCs

With respect to supplies by NRCs to taxable persons in Nigeria, the FA 2021 empowers the FIRS to appoint any party to withhold or collect the relevant VAT, and remit to the FIRS. Prior to the FA 2021, the person appointed was able to only "withhold and remit". This amendment therefore clarifies the powers of the FIRS and the responsibilities of the NRC or appointed agent. The NRC is required to charge, collect and remit VAT while the Nigerian customer only has a secondary obligation to self charge, withhold and remit the tax where the NRC fails to do so.

CIT

FA 2021 introduces a "deemed profits" tax regime for non-resident companies that create a Digital Significant Economic Presence (SEP) in Nigeria. In any year where the non-resident has no assessable profits or declares assessable profit that the tax authorities believe to be less than expected, the non-resident may be assessed to tax as a percentage of its turnover attributable to the SEP. In practice, a 20% margin is deemed on turnover and subjected to CIT at 30% (resulting in an effective rate of 6% of turnover).

This is likely to create some dispute between the non-residents and the tax authorities considering that the law does not clearly define the parameters for determining if the assessable profits declared are less than expected. The law does not also define the "reasonable percentage" that would be applied on turnover however, it is expected that the FIRS is likely to apply the 6% historically used for other permanent establishments that existed before the introduction of the SEP concept.

Takeaway

Taxation of the digital economy remains a key focus for the government in its drive to grow tax revenue. The FA 2021 continues to build on measures earlier introduced by the previous FAs.

Requesting that all NRCs that transact with Nigerian customers should register for VAT will be challenging, as it will be difficult to enforce. It would have been more feasible for the registration requirement and primary responsibility for collection to be limited to NRCs that have a Digital SEP or some form of physical presence in Nigeria.

Affected taxpayers may engage with the FIRS for a lower "fair and reasonable" rate for Digital SEPs, different from the 6% of turnover especially for low margin digital supplies.



Energy and Utilities sector

04



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Implications for the Energy and Utilities sector

Overview

The year 2021 marked a significant breakthrough in Nigeria's energy sector following the enactment of the Petroleum Industry Act (PIA). It is projected that the PIA would improve the competitiveness of Nigeria's oil and gas sector and further bolster the Federal government's drive for revenue growth. However, the global climate change concerns and energy transition pose a serious threat to oil and gas exploration in Nigeria and could negatively affect the economy due to the country's reliance on oil export revenue. Despite this threat, it is believed that policies such as the "Decades of Gas", will help in Nigeria's transition to relatively cleaner energy and the optimal utilisation of its huge gas reserves.

Meanwhile, the power sector recorded a lackluster performance in 2021 despite measures adopted by the government and relevant stakeholders to improve the performance of the sector. Some of the identified factors for this trend include the collapse of the national grid, insufficient gas supply, unpaid electricity bills, etc. The planned revival of the Siemens AG power project aimed at improving Nigeria's power generation capacity to 25,000 megawatts and the continuous distribution of pre-paid meters could help improve the performance and outlook of the power sector.

Specific Changes in the Finance Act (FA) 2021

Capital Gains Tax (CGT) on disposal of shares

The FA 2021 amends the CGT Act to impose CGT at 10% on gains from the disposal of shares worth N100m or above in any 12 consecutive months, except to the extent that the proceeds are reinvested in the shares of any Nigerian company. CGT will accrue proportionately on the portion of sales proceeds not reinvested in the above manner. This would make share deals less attractive for divestment in addition to the reluctance of buyers taking over historic liabilities in companies through acquisition of shares.

Export profits for companies engaged in the Upstream, Midstream or Downstream Petroleum operations.

Prior to the FA 2021, CITA exempted profits of any Nigerian company in respect of goods exported from Nigeria, if the proceeds of such exports are used for the purchase of raw materials, plant equipment and spare parts.

The FA 2021 now excludes companies engaged in the Upstream, Midstream or Downstream Petroleum operations from this exemption.

The implication of this is that companies engaged in the upstream, midstream or downstream operations will be subject to CIT on proceeds from exports of their products even when such proceeds are used for the purchase of raw materials, plant equipment and spare parts. This amendment seeks to prevent oil and gas from being exempted from CIT on the exportation of crude oil and gas but may inadvertently discourage the sector from diversifying into other petroleum products for exports.

Minimum Tax

The FA 2021 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 two accounting periods ending on any date between 1 January 2019 and 31 December 2021.

This incentive will help reduce the tax burden on companies with low margins such as downstream petroleum businesses and also help cushion the effect of the COVID-19 pandemic. It also provides clarity on the application of the reduced rate.

The return of the rate from 0.25% to 0.5% will adversely impact the downstream sector except the price of products (especially for PMS) is adjusted to reflect market price. This is in addition to the increase of 0.5% to the Tertiary Education Tax rate (to make it 2.5%), the introduction of a levy for Midstream and Downstream Gas Infrastructure Fund of 0.5%, and the introduction of a levy of 0.5% payable to the Midstream and Downstream Regulatory Authority. The industry would have no other feasible option than to increase prices to compensate for these multiple taxes.

Capital Allowance restriction

The FA 2021 restricts the claim of capital allowances to the portion of qualifying assets used for generating taxable profits. Capital allowance on assets exclusively used to generate tax-exempt profits will not be claimable, and capital allowance on assets that are partially used for generating taxable profits will be prorated. The restriction will only apply where the proportion of non-taxable income exceeds 20% of the company's total income. This restriction does not apply to companies who enjoy tax exemption under the pioneer incentive scheme in line with the Industrial Development (Income Tax Relief) Act (IDITRA).

Implications for the Energy and Utilities sector

The FIRS may seek to extend this restriction to companies who enjoy tax exemption under the gas utilisation incentive scheme and restrict them from carrying forward their unutilised capital allowances calculated during the tax free period. Where this occurs, companies that qualify for both incentives may consider opting for pioneer status in order to preserve the tax shield from their fixed assets.

Gas Utilisation Incentives

The FA 2021 introduces an amendment for companies that benefit from the gas utilisation incentives. The gas utilisation incentive provides for an initial tax-free period of 3 years subject to renewal for an additional 2 years subject to the satisfactory performance of the business.

The amendment requires that companies can only enjoy this incentive once. Based on the amendment, any new company formed from reorganisation, restructuring, buyback or other similar schemes out of a company which has already enjoyed this incentive will not be entitled to the incentive. In addition, any company that has previously claimed an incentive for trade or business of gas utilization under any law in Nigeria, including the Petroleum Profits Tax Act (PPTA) or the incentives under the Industrial Development (Income Tax Relief) Act (IDITRA) will not be eligible for this incentive.

National Agency for Science and Engineering Infrastructure Act (NASENI Act)

NASENI was established in 1992 under the NASENI Act to contribute to science and technology advancement in Nigeria. Pre-FA 2021, the Act imposed a levy of 0.25% of the turnover of commercial companies. However, there was no clarity on the modalities for administering the levy and it was not assessed in practice.

The FA 2021 now empowers the FIRS to collect the levy, and provides that the levy be computed at 0.25% of the profit before tax (as against turnover) of commercial companies in the banking, mobile communication, ICT, aviation, maritime, and oil and gas sectors. The threshold to be liable for the levy is annual turnover of N100m and above.

Takeaway

There is a continued drive by the government to generate more revenue and reform the oil and gas sector, culminating in the recent passage of the PIA. However, there are increasing cases of divestments in the oil and gas sector due to a number of issues including the global shift to clean energy. The inclusion of CGT on disposal of shares will also have implications in this regard.

Based on the PIA, companies operating in the oil and gas sector are required to pay CIT and Hydrocarbon Tax (HCT) and companies who operate using the production sharing contract (PSC) are only liable to HCT. The exclusion of export profits for the upstream sector is consistent with the provisions under the old regime as the majority of the revenue earned by players in the sector is from exports of crude oil. Nonetheless, this may be a disincentive to the players in the midstream and downstream sectors.

Although the NASENI Act prescribes that the FIRS will collect the levy, it does not contain specific administration provisions. For example, the Act does not prescribe any penalties in the event of defaults. The financial burden for large companies is somewhat reduced by way of deduction against CIT (resulting in an effective tax rate of about 0.175%). Further regulations are expected with respect to this levy.

The clarity on the application of the reduced minimum tax rate is welcome, especially for companies in the energy sector who have low profit margins. The minimum tax regime continues to be a huge burden for companies who pay income taxes even when they are legitimately not profitable. In jurisdictions like Kenya, there is a Federal High Court ruling declaring that minimum tax is unconstitutional and violates the principle of fair treatment, particularly affecting businesses in a loss-making position. We expect to see situations where taxpayers in Nigeria may challenge the application of minimum tax on loss making businesses as being unconstitutional.

Micro, Small and Medium-Sized Enterprises

05



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Implications for Micro, Small and Medium-Sized Enterprises

Overview

Micro, Small and Medium Enterprises (MSMEs) play a significant role in developing countries, and account for the majority of businesses worldwide. According to the [World Bank](#), MSMEs contribute about 50% of Nigeria's GDP and account for over 80% of employment in the country.

In order to sustain and encourage the growth of the sector, the Nigerian Government has in the past provided some tax reliefs to MSMEs, and to a large extent continues to do so with the new Finance Act (FA) 2021. We examine some of the changes introduced by the FA 2021 that will affect MSMEs below.

Companies Income Tax (CIT)

Capital Allowance

The FA 2021 restricts the claim of capital allowances to the portion of qualifying assets used for generating taxable income. Capital allowance on assets exclusively used to generate tax-exempt profits will not be claimable, and capital allowance on assets that are partially used for generating taxable income will be prorated. Therefore, small companies will not be able to deduct or carry forward capital allowances in respect of qualifying capital expenditure incurred during the tax exempt period.

For small and medium companies, the FA provides that capital allowances for each year, together with any unabsorbed capital allowances brought forward, will be deemed to be utilised. However, such companies can carry forward the tax residue (tax written down values) of qualifying assets to subsequent periods when it may become taxable. Companies under pioneer status are exempt from this provision.

Minimum Tax

The reduction of the minimum tax rate from 0.5% to 0.25% of turnover (less franked investment income) will apply to any two consecutive accounting periods between 1 January 2019 and 31 December 2021 as may be chosen by the taxpayer. This addresses previous ambiguities relating to the period covered by this incentive. However, the exemption will only be granted where the relevant returns are filed before the filing due dates.

Personal Income Tax Act

The FA 2021 excludes from allowable deductions, premiums relating to contracts for a deferred annuity on a taxpayer's life or the life of his/her spouse. These are contracts that guarantee an agreed income in the event that the policy holder lives beyond an expected age. Individual taxpayers are no longer able to obtain tax deductions for premiums relating to deferred annuity contracts, except those obtained under the provisions of the Pension Reform Act. Life assurance premiums on the other hand remains tax deductible. However, this will be subject to a lot more scrutiny to determine whether it is a fictitious transaction or not. This amendment is expected to affect premiums paid for the period from 1 January 2021.

Value Added Tax (VAT)

Companies with annual taxable supplies below NGN 25 million are not required to issue a tax invoice. However, companies engaged in upstream petroleum operations are required to comply with all VAT requirements regardless of their turnover.

Capital Gains Tax (CGT)

Gains on the disposal of shares and stocks were previously exempt from CGT. The FA 2021 now amends the CGT Act to impose CGT at 10% on gains from the disposal of shares worth NGN 100 million or above in any 12 consecutive months, except to the extent that the proceeds are reinvested in the shares of any Nigerian company. CGT will accrue proportionately on the portion of sales proceeds not reinvested in the above manner.

Relevant state Revenue authorities will collect CGT on the disposal of shares by individuals, while the Federal Inland Revenue Service (FIRS) will collect from companies on any chargeable gains.

Tertiary Education Tax (TET)

TET which was previously computed as 2% of assessable profits of Nigerian companies, has now been increased to 2.5%. Small companies will remain exempted from paying TET. However medium-sized companies would be affected by this rate increase.

Implications for Micro, Small and Medium-Sized Enterprises

Federal Inland Revenue Service (Establishment) Act

The FIRS can now deploy third-party technology (the laws previously only provided for proprietary technology) to automate the tax administration process, including assessments and information gathering. The FA 2021 requires the FIRS to give 30 days' notice to taxpayers, with the FIRS reserving the right to withdraw or extend the notice if the taxpayer shows "good cause". There is now an administrative penalty of NGN25,000 for every day that the taxpayer fails to grant access to the FIRS.

Nigerian Police Trust Fund (Establishment) Act (NPTF Act)

The NPTF Act was signed into law in June 2019, and establishes a fund, proceeds from which will be used to train police personnel and procure security machinery and equipment. The Act imposes a levy of 0.005% of the "net profit" of companies carrying on business in Nigeria. However, there was previously no clarity on the modalities for assessing and administering the levy.

The FA 2021 has now clarified that the FIRS will administer the levy, and that relevant provisions in CITA and the FIRSEA will apply in respect of administration, assessment, collection, and enforcement. Therefore, companies (including MSMEs) operating in Nigeria will be required to comply and pay the levy. However, the exposure may not be material in view of the rate.

There are still some unanswered questions, such as whether the FIRS will seek to enforce collection of the levy from 2019 or prospectively, the lack of a definition of 'Net profit', the forms to be used for filing, whether this levy will apply to non-resident companies, and so on. It is expected that the FIRS will clarify some of the above issues.

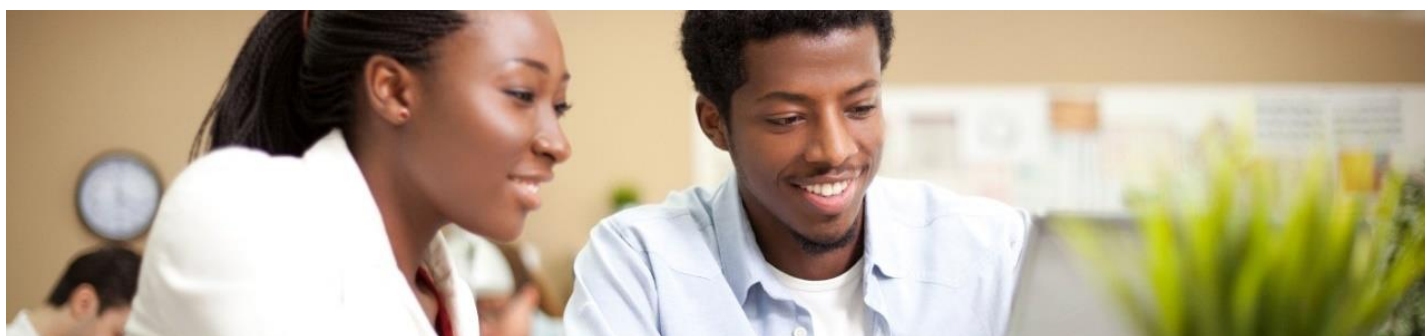
Takeaway

Considering that CITA typically accelerates the capital allowance available for deduction in the first year that assets are used, it would be difficult to reasonably apportion capital allowances to profits generated over the life of the relevant assets. In addition, small companies that transition into medium or large companies could be worse-off as they would not be able to carry forward commensurate capital allowances in respect of assets acquired in the tax exempt period.

Also, the FA 2021 provides that medium-sized companies would be deemed to have utilised their yearly and any brought forward capital allowances. This would be a disadvantage to such companies in years where they are loss-making or generate profits that cannot absorb all the capital allowances computed each year as such capital allowances will be essentially wasted. Medium-sized companies are not exempt from CIT and therefore this amendment may not be in line with the intention, which is to ensure that companies only get tax deduction for capital expenditure incurred in generating taxable profits.

While the increase of the TET rate is aimed at helping the government generate revenue to improve the education sector, this increase would have a negative impact on the affected companies, especially medium-sized entities.

In conclusion, the government should reassess and review the implications of some of the changes introduced as they impact MSMEs. Also, beyond granting incentives, there should be deliberate and sustained efforts to address the challenges and impediments facing MSMEs including multiplicity of taxes, complex regulations, access to credit and capacity building.



Public Sector

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Implications for the Public Sector

Overview

Public sector funding and financial management has been a focal point for increased legislation and legislative amendments in recent times. Citizens have been more vocal about the need for more accountability with taxes and management of public revenue.

The Finance Act of 2020 (FA 2020) introduced amendments to the Fiscal Responsibility Act (FRA) and the Public Procurement Act (PPA) with the aim of increasing transparency in government expenditure.

The FA 2021 similarly amends principal legislation in public sector finance - the FRA and the Finance (Control and Management) Act (FCMA) to enhance transparency and accountability in public sector financial management. The Act also includes some amendments impacting the Federal Inland Revenue Service (FIRS).

Finance (Control and Management) Act

The Act introduces additional provisions to emphasise the role and responsibility of all government institutions, Ministries, Departments and Agencies (MDA) in revenue collection for the government. Other government institutions and MDAs are required to specifically adhere to sections 80 and 81 of the Constitution of the Federal Republic of Nigeria (the Constitution) relating to the Appropriation Act and the Consolidated Revenue Fund (CRF). This will require MDAs and other government institutions to remit all undesignated monies they receive, directly into the CRF. Withdrawals from the CRF will only be permitted where such expenditure is authorised by the Appropriation (or similar) Act. All taxes and levies received by the Federal Government (FG) or any agency of the FG are required to be paid in gross into the CRF or any relevant special account specified in the Constitution or the enabling Act of the National Assembly.

The introduction of *other institutions of the FG* extends the scope of this obligation to the federal Legislature and Judiciary and their departments or units.

The Minister of Finance (MoF) is empowered to issue guidelines and regulations on the handling of and accounting for public monies, stamps and negotiable instruments. All MDAs, other government institutions and public officers coming within scope are required to comply with any guidelines or regulations. Non compliance will be deemed an offence punishable with a maximum of 5 years imprisonment or N5m or both upon conviction. The scope here covers public officers either alone or jointly with any other person.

Thus, one can assume that consultants (individuals and private firms or companies) sometimes engaged by government institutions or MDAs for revenue collection purposes will come under this obligation.

Fiscal Responsibility Act

The amendment creates an additional basis for borrowing by all tiers of government to enable them carry out “critical reforms of significant national impact” when required. Currently, governments at all tiers are only empowered to borrow for capital expenditure and human development. Critical reforms of significant national impact have not been defined to guide on what these may constitute. The risk in this broad category is that it is open to diverse interpretation by the different tiers of government and therefore prone to abuse which is contrary to the FRA’s objective of accountability in the nation’s financial management.

Sundry Amendments impacting FIRS

An amendment to the Federal Inland Revenue Service (Establishment) Act (FIRSEA) reiterates the FIRS’ role as the primary FG agency responsible for the administration, assessment, collection, accounting and enforcement of all taxes and levies due to the Federation and the FG or any of its agencies, except otherwise authorised through a regulation issued by the MoF.

It further requires any person or agency who becomes aware of matters requiring tax investigation, enforcement and compliance to refer such matter to FIRS for necessary actions. Nonetheless, FIRS may collaborate with such a person or agency in conducting the tax investigation and/or enforcement. Failure to do so makes the relevant public officer liable to a fine of NGN10 million and/or imprisonment for a maximum prison term of 5 years or both upon conviction.

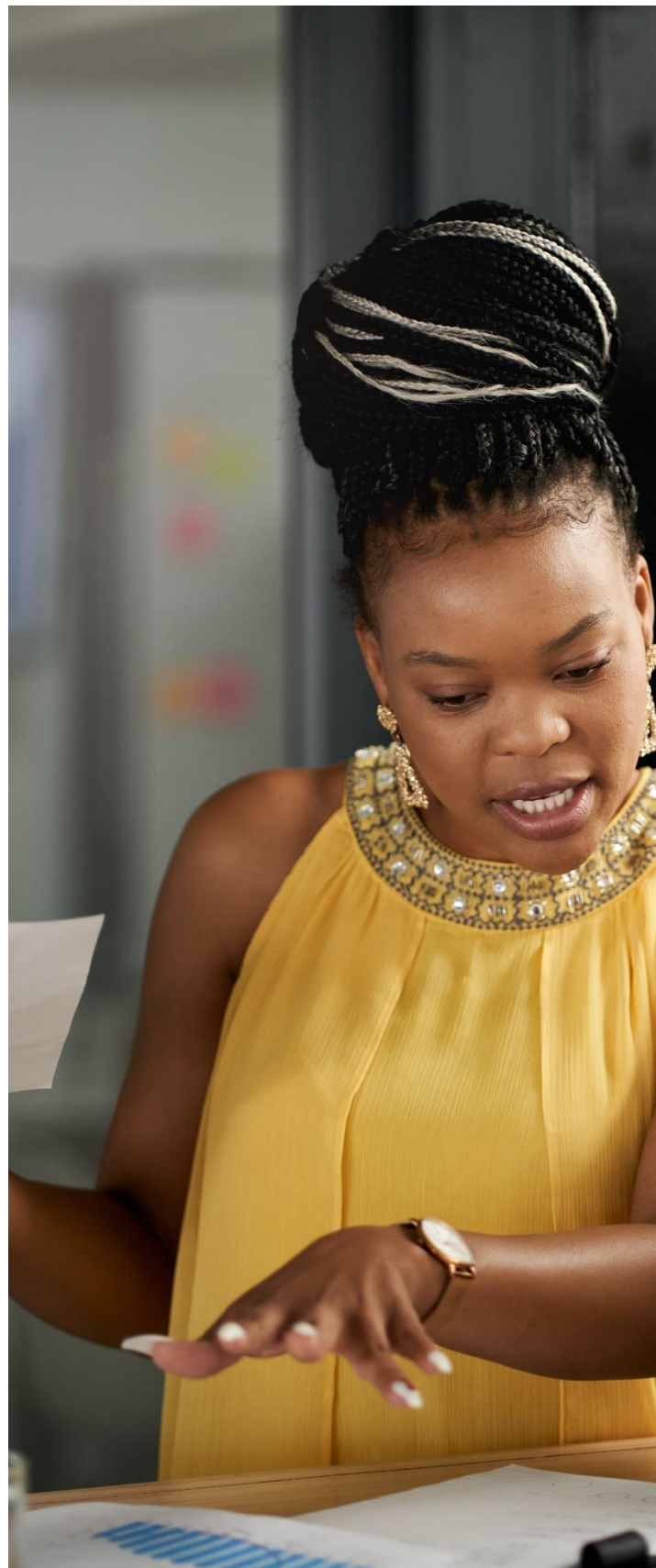


Implications for the Public Sector

Takeaway

The positive step taken towards legislative control and management of public finances, if adequately enforced will secure greater accountability and transparency in fiscal operations. There is however an urgent need to determine what constitutes “critical reforms of significant national impact” as the broad term may become an instrument of abuse and misapplication.

Finally, the provision requiring referral of any infraction that may warrant a tax investigation to FIRS for necessary action, is expected to reduce multiplicity of tax investigations. There have been occasions where different government agencies sought to carry out tax audits, including the Nigerian Postal Service (NIPOST), the EFCC, the Revenue Mobilisation Allocation and Fiscal Commission (RMFAC), etc. This creates undue administrative burden on private businesses. With this amendment, the FIRS is empowered to collaborate with the relevant agency to undertake investigations. This should create a more taxpayer friendly system as investigations will emanate from FIRS in collaboration with any other relevant/concerned agency. It would also eliminate multiplicity of uncoordinated (sometimes concurrent) investigations on similar issues which can be disruptive for businesses.



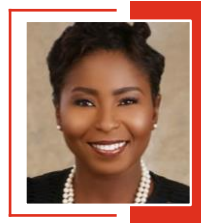
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