Is it a tax or a levy? What you should know about the new changes introduced by IFRIC Interpretation 21 on Levies.

Specifically, the major distinction between income taxes and levies is that the former is based strictly on taxable profit while the latter is payable without regard to taxable profit.

The Black's Law Dictionary defines a tax as a charge, usually monetary, imposed by the government on persons, entities, transactions, or property to yield public revenue. Most broadly, the term embraces all governmental impositions on persons, property, privileges, occupation, and enjoyment of the people, and includes duties, imposts, and excises.

On the other hand, a levy in this context is defined by the Webster Dictionary as an amount of money that must be paid and that is collected by a government or other authority.

If the above broad definitions are anything to go by, then one can erroneously conclude that a levy is a tax and a tax is a levy. However, the truth is that this may not always be the case. But you may ask - how does it matter? Well it matters especially from a tax accounting and reporting perspective. The distinction will impact on how and when to recognise a liability, contingent or otherwise, to pay a levy.

Nigeria has adopted the International Financial Reporting Standards (IFRS) as the basis for preparing financial statements by reporting entities. The International Accounting Standards Board (IASB), the body under which IFRSs are produced, also has a committee that provides

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clarifications and interpretations on grey areas of accounting standards. This committee is known as the International Financial Reporting Interpretation Committee (IFRIC).

In May 2013, the IASB issued IFRIC Interpretation 21 on Levies which takes effect from 1 January 2014. IFRIC 21 provides guidance on when to recognise a liability for a levy imposed by a government whether or not the timing and amount of the levy is certain. For the purpose of IFRIC 21, a levy is an outflow of resources embodying economic benefits that is imposed by governments (including government agencies and similar bodies) in accordance with laws and/or regulations. However, it does not include income taxes (covered by International Accounting Standard 12 Income Taxes), fines and other penalties, liabilities arising from emissions trading schemes and outflows within the scope of other Standards. A levy should not be confused with a charge or a fee payable to government to acquire an asset, or for the rendering of services such as water treatment or waste disposal.

Based on IFRIC 21, there must be an obligating event for the recognition of a liability as the activity that triggers the payment of the levy in accordance with the relevant legislation. The Interpretation clarifies that 'economic compulsion' and the going concern principle do not create or imply that an obligating event has occurred. In other words, it is not appropriate to accrue for a liability to pay a levy simply because the entity must pay the levy in order to continue in business in the future.

IAS 12 states that income taxes include all domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity. Specifically, the major distinction between income taxes and levies is that the former is based strictly on taxable profit while the latter is payable without regard to taxable profit.

There are numerous levies in Nigeria that fall into the scope of IFRIC 21. Some of such levies include:

- Local content levy based on the Nigerian Oil and Gas Industry Content Development Act calculated as a percentage of contract sum
- Niger-Delta Development Commission (NDDC) levy based on the NDDC (Establishment etc) Act and calculated as a percentage of annual expenditure budget
- Cabotage surcharge based on the Coastal and Inland Shipping (Cabotage) Act calculated on the contract fees
- Industrial Training Fund (ITF) levy based on the ITF Act as a percentage of payroll cost
- Pioneer status service charge based on the Pioneer Status Incentive Regulations as a percentage of projected tax savings.

Impliedly, the above levies should not be accounted for as part of tax expense in the income tax line immediately after "Profit Before Tax (PBT)". Rather, they should be accounted for as part of general expenses or be capitalised along with the related assets as the case may be. Only outflows of economic benefits imposed by legislation which are calculated based on taxable net margin can now be treated as income tax.

There are however situations where the obligation behaves both like an income tax within IAS12 and a levy within the scope of IFRIC 21. For example, in respect of the Minimum Tax, the law requires a payment of minimum tax whenever there is no net taxable margin or the net taxable margin gives rise to tax that is less than the minimum tax. It appears reasonable that the minimum tax should be treated as a levy (and therefore expensed) where a company has no taxable profit. On the other hand if the taxable profit is less than the minimum tax, there should be a split between income tax and levy.

Also, there is ambiguity created by legislation in some cases. An example of this is a situation where the legislation on income taxes deems the net taxable margin based on an item that is closely related to profit such as dividend. For example, a company can be subject to additional income tax on the excess of dividend distributed from the profit of a particular year above the taxable net margin of the same year determined based on general tax rule. In this regard, the dividend is deemed to be the taxable net margin. Although required by the income tax legislation, the income tax assessed based on profit distribution should be regarded as a levy within the scope of IFRIC 21.

Similarly, income tax payable by a non-resident company in Nigeria may be levied on a percentage of turnover through the deemed profit mechanism whereby taxable profit is deemed to be 20% of income without considering actual expenses. Such a deemed profit tax could be considered as a levy but in substance it is an income tax to the extent that it represents actual net margin of the company otherwise any excess is a levy.

A major issue regarding the timing of recognition will be encountered where there is no clear indication in the various laws as to when the levies are due or payable and if they are triggered by an event. A good example here is the NDDC levy which imposes a three percent charge on the total annual budget of oil producing (including gas processing) companies operating in the Niger-Delta. The triggering event is the annual budget but there is no timeline for all affected companies to draw up their budgets. Therefore, a practical solution would be to view this as an annual cost and therefore match the cost against revenue of relevant period notwithstanding that the trigger is the annual budget. In practice, the levy cannot be avoided by the failure to prepare a budget.

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