Still on Excess Dividend Tax
Why is the National Assembly slow to act?

One of the major reasons many companies, multinationals and domestic alike, choose to locate their companies outside Nigeria is to avoid the excess dividend tax exposure.

According to the U.S. Census Bureau, the United States of America currently has a population of 318 million and over 16.5 million establishments. Compared to Nigeria, with a population of over 170 million, there are less than 1 million active companies. Assuming the same level of development, Nigeria should have about 9 million companies. Put differently we are operating at about 11% of our capacity. It is therefore not difficult to see why Nigeria has a high unemployment rate. South Africa with 54 million people (less than one-third of Nigeria), has 2.2 million companies (more than twice the number of companies in Nigeria).

In the recently released 2014- 2015 Global Competitiveness Index by the World Economic Forum, Nigeria has just been ranked 127 out of 144 countries. On the ease of doing business, Nigeria ranks 147 out of 189 economies in the 2014 Doing Business Report by the World Bank which measures different aspects of business including paying taxes.

The facts are quite obvious that top ranking countries fair better economically. Even if we dispute the surveys or their methodologies, why don't we imitate their reform models and see if we will get a better outcome. Our inactions and sometimes negative reforms are the reasons we are unable to achieve our full potential. One of the major reasons many companies, multinationals and domestic alike, choose to locate their companies outside Nigeria is to avoid the excess dividend tax exposure.

The vexatious provision

The relevant provision in the extant law is Section 19 of the Companies Income Tax Act (CITA) LFN 2004 which states that:

"Where a dividend is paid out as profit on which no tax is payable due to -

a. *no total (means taxable) profits; or*
b. *total profits which are less than the amount of dividend which is paid, whether or not the recipient of the dividend is a Nigerian company, the company paying the dividend shall be charged to tax at … [30%] as if the dividend is the total profits of the company for the year of assessment to which the accounts, out of which the dividend declared, relates."*

Implications

The implications of the above provision is that while it is was designed to prevent companies from avoiding tax on any income on which tax is payable, the current interpretation and application by the Federal Inland Revenue Service (FIRS) is to the effect that companies suffer double taxation in many cases or are made to pay tax on their legally exempt profits. This has the following specific effects:

- A company that delays the distribution of profit to its shareholders for reinvestment in one period will be subject to tax again on such profit when subsequently paid out as dividend.

- A company that distributes dividends from realised capital gains after paying the applicable capital gains tax will be subject to companies income tax on the dividends paid notwithstanding that the applicable tax has already been paid.

- A company that receives dividends from a subsidiary, associate and other equity investments will suffer tax when it further distributes the dividends to its shareholders. This is contrary to the provisions of Section 80(3) of CITA which provides that dividend received by a company in this situation shall not be subject to any further tax.

- Under the Industrial Development (Income Tax Relief) Act, the pioneer profits of a company are exempted from income tax regardless of the timing of distribution by way of dividend. These profits should therefore not be subject to tax under section 19 where the dividends are paid post-pioneer if such dividend is more than the taxable profits for the year.

Proposed changes

Here is a possible amendment of the section to avoid the above unintended consequences:
Section 19 Dividend Tax Account

1. A Nigerian company shall maintain a Dividend Tax Account in accordance with the provisions of this Section.

2. The initial amount in the Dividend Tax Account shall be established in accordance with subsection (6) and the balance of the Dividend Tax Account as of the date of filing tax returns in accordance with Part IX of this Act shall be carried forward to the subsequent year of income.

3. The dividend Tax Account shall be increased subsequently by:
   a. the amount of profit which has been subjected to tax under the provisions of this Act;
   b. the amount of income received as Franked Investment Income by the company and to which Section 80(3) of this Act relates;
   c. the amount of any profit exempt from taxes by virtue of the provisions of the Industrial Development (Income Tax Relief) Act;
   d. the amount of any income or profit exempt from tax under this Act; and
   e. the amount of any gains which has been taxed under the Capital Gains Tax Act or any other law repealing, amending or replacing the Capital Gains Tax Act

4. The Dividend Tax Account shall be decreased by an amount equal to the dividends paid by the company to its shareholders in any accounting period commencing from the creation of the Dividend Tax Account.

5. Where the balance in the Dividend Tax Account is decreased below zero in any year of assessment as a result of the deduction made under subsection (4) above, the balance shall be charged to tax at the rate prescribed in subsection (1) of section 40 of this Act.

6. The initial balance in the Dividend Tax Account shall be determined as follows -
   a. In the case of a company which has no distributable reserve as at the commencement of this Section, zero; and
   b. In the case of a company which has distributable reserves as at the commencement of this Section, such amount of the undistributed profits accrued in accordance with Subsection 3 of this Section.

The bulk of the issues stated earlier arise due to the misinterpretation of the section by the FIRS. The lawmakers should therefore amend the law to make the section crystal clear as a solution to the problems. I have suggested the above changes to the National Assembly since 2012 to amend the provisions of Section 19 of CITA. It is difficult to understand why this has not been considered. If amended as proposed, it will ensure that the law achieves the intended purpose of subjecting taxable but untaxed profits to tax and at the same time avoid subjecting companies to double taxation or subjecting exempt profits to tax. This will encourage investments and establishment of holding companies in Nigeria.

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