Stimulating employment and infrastructure:
How far can tax incentives go?

By Taiwo Oyedele

Within the past 5 years there has been an average of about 2 million new entrants into the active labour market. Unfortunately, employment generation during the same period averaged only 160,000 per year with declines recorded in 2009 and 2011. As a result, unemployment rate has increased steadily from 12.3% five years ago to 23.9% in 2011.

The International Labour Organisation (ILO) defines unemployment to covers persons aged 15 to 64 who during the reference period were available for work, seeking for work, but were unable to find work.

According to the National Bureau of Statistics (NBS), Nigeria's unemployment was 23.9% in 2011. In computing the unemployment rate, the total population is divided into labour force (currently active) and non-labour force (not currently active). The unemployment rate is determined as a percentage of economically active labour force (persons aged 15 to 64 years) who during the reference period were available for work, seeking for work but were without work. A person is regarded as employed if he/she is engaged in the production of goods and services, in whatever shape or form. So a university graduate who rides *Okada*, works as a driver or engages in farming is considered employed. This effectively disregards underemployment and casual or temporary employees who may consider themselves unemployed but are not included in the data.

Just to put things in proper perspectives, Nigeria's population is currently estimated at 164 million out of which 92 million are economically active. Of this number, the labour force is 67 million out of which 51 million are employed *(never mind our definition of employment)*. Hence the 23.9% unemployment rate translates to about 16 million.

Within the past five years there has been an average of about 2 million new entrants into the active labour market every year. Unfortunately, employment generation during the same period averaged only 160,000 per year with declines recorded in 2009 and 2011. As a result, unemployment rate has increased steadily from 12.3% five years ago to 23.9% in 2011.

In a bid to address unemployment, a new Companies Income Tax (Exemption of Profits) Order 2012 dated 30 April 2012, signed and effective from 27 April 2012 has recently been gazetted by the President, Federal Republic of Nigeria. The Order provides for Employment Tax Relief, Work Experience Acquisition Programme Relief, and Infrastructure Tax Relief.

Under the Employment Tax Relief, any company that employs a net of 10 employees within the assessment period; 60% of whom are employees without any form of previous work experience within 3 years of graduating from school or vocation will be entitled to exemption from income tax on 5% of its assessable profit in the assessment period in which the profits were generated. However the tax exemption is restricted to the gross salaries paid to the qualifying employees being only Nigerians actively employed in Nigeria by the company on a full time basis, who do not hold any other employment and whose employment duties are primarily discharged in Nigeria. It is not clear if qualifying employees mean only the net employees defined as “the difference between incoming and outgoing employees of the company within the assessment period” or whether the restriction is with reference to the salaries paid to all new employees. If the former then the incentive is likely to be negligible for many organisations and if the latter then the incentive will be rewarding employers who fire old employees in order to hire new ones. Qualifying employees exclude employees from the same immediate family.

In respect of the Work Experience Acquisition Programme Relief, this is applicable to any company with a minimum net employment of 5 new employees; who must be retained for a minimum of 2 years from the year of assessment the employees were first employed. The tax relief for this purpose is exemption from income tax of 5% of assessable profit in the assessment period in which the company qualifies. The exemption must be utilized only in the year of assessment in which the company qualifies; any unabsorbed deductions cannot be carried forward to subsequent assessment years.

Beside employment generation, the Order also provides for Infrastructure Tax Relief to stimulate the provision of public infrastructure. The incentive is available to any company that incurs expenditure on infrastructure or facilities of a public nature such as power (electricity), roads and bridges, water, health, educational and sporting facilities. The tax relief is granted by way of exemption from income tax of an additional 30% of the cost of the infrastructure in the assessment period in which facility was provided. To qualify, the infrastructure or facilities must have been completed and in use by the company and must be accessible for use by the public except where impracticable or an exemption has been obtained from the Minister of Finance. It is not clear whether the intention is to make such infrastructure available to the public free of charge or whether a company can charge for the use of the facilities by the public. The exemption is in addition to the usual deductions under the Companies Income Tax Act and can be enjoyed in the assessment period in which the infrastructure was provided or be carried forward for a maximum of 2 assessment periods.

To qualify for the employment incentives, the statutory auditor of the company is required to certify by stating in details the particulars of all employees in respect of which the company qualifies for exemption including name, qualification, job title, date employed, gross pay and PAYE tax paid to the relevant tax authorities. In the case of infrastructure incentive, the certification must state in details the nature of infrastructure with supporting documentation, date of completion, and a statement to the effect that such infrastructure or facility is in use by the company and accessible to the public except where impracticable or if exemption has been granted by the Minister of Finance. All the incentives are available for only 5 years from 27 April 2012 and claimable only by companies with a Tax Identification Number issued by the Federal Inland Revenue Service (FIRS).

Although the new incentive may be well intended, it is doubtful if it will lead to any marked improvement vis-à-vis the cost of the incentive. It is estimated that, more than 70% of Nigerians in employment are engaged in farming or employed by small and medium size enterprise (SMEs). Yet due to the harsh operating environment, empirical evidence shows that only 6 out of every 100 start-ups make it to their 5th anniversary while only 4 eventually make it to the 10th anniversary.

It therefore follows that to generate employment and ensure economic growth that will translate into prosperity for the ordinary people; government must put in place infrastructure and investment friendly policies to enable the private sector flourish especially SMEs. As a natural consequence, businesses will hire more people on a sustainable basis when driven by growth rather than incentives. There is no reliable data to show the impact of existing tax incentives in the area of infrastructure for example. Investors don’t just want incentives, what they crave for is a conducive business environment incorporating a sensible tax system where policies are predictable and are consistently applied in a business friendly manner.

Some of the major policies discouraging investment in Nigeria include the requirement in the Companies and Allied Matters Act for a foreign company wishing to carry on business in Nigeria to incorporate a Nigerian company for that purpose. Many times the nature and duration of business to be undertaken do not require incorporation where a branch or representative office will do. There is also commencement rule under the income tax laws, which levies double taxation on the profit of a start-up company. In addition, there is excess dividend tax provision which penalises a group of companies and other entities that invest their profits rather than distribute them. When such profits are subsequently distributed, the company is made to suffer addition 30% tax on the past profits reinvested. As a matter of fact, the excess dividend tax provision nullifies the effect of any tax incentive including those granted by this new Order in the sense that any exempt profits are taxed upon distribution. These issues must be addressed as a matter of urgency to stimulate employment and infrastructure. Tax incentives, if at all to be granted, government should seek input from relevant stakeholders to ensure the overall desirability of such incentives.

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