The Finance Act 2020:

Rejigging the Nigerian Fiscal Landscape

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Intro duction

On January 13, 2020, the President of the Federal Republic of Nigeria signed the Finance Act 2020 (the "Finance Act" or the "Act") into law, and the Minister for Finance has announced February 1, 2020 as the commencement date for the implementation of the Act. The Finance Act is an omnibus legislation that touches on major thematic aspects of the Nigerian fiscal landscape. As a legislative bill, it was introduced to the National Assembly by the Executive arm of government alongside the 2020 Budget. The Act amends the Companies Income Tax Act ("CITA") , the Value Added Tax Act, the Customs and Excise Tariff Act, the Personal Income Tax Act, the Capital Gains Tax Act, the Stamp Duties Act, and the Petroleum Profits Tax Act.

The focus of this legislation as captured by the introductory letter of the President to the National Assembly includes promoting fiscal equity by mitigating instances of regressive taxation, reforming domestic laws to align with global best practices, introducing fiscal incentives to promote investments in infrastructure and the Nigerian capital market, supporting small businesses in line with the ongoing Ease of Doing Business Reforms and raising revenues for the government through fiscal measures.

In terms of its impactfulness within the Nigerian business sector, the Finance Act is the first of its kind in over two decades and is intended to support the funding of the 2020 budget.

This article highlights some of the major features of this new Law.

Accordingly, the profits derived by non-resident digital businesses from online activities, such as advertising, movie streaming, online gaming stores, e-commerce, etc., from their users/subscribers in Nigeria will now come within Nigeria's fiscal net, where so determined by the Minister.

Quoted from **Taxation of non -resident companies**

COMPANIES INCOME TAX ACT (CITA)

Prevention of Multiple Taxation

In order to prevent multiple taxation on a company's income, Section 9 of the CITA has been amended such that company income tax can only be payable on such part of a company's income that is not subject to Capital Gains Tax, Petroleum profit tax and personal income tax

Regulated Securities Lending Transactions

The definition of taxable interest has been expanded to include compensating payments received by a borrower from its approved agent; or compensating payments by a lender in securities transaction conducted pursuant to the rules made by the Securities and Exchange Commission ("SEC"). "Compensating Payments" are defined as any payments made in lieu of interest or dividend payable under a securities transaction conducted under the rules of the SEC.

The Act has clarified that in a securities transaction regulated by the Securities and Exchange Commission, securities or shares are not deemed disposed of or acquired by a lender, borrower or approved agent if such securities or shares are transferred from a lender to a borrower and subsequently returned by the a borrower to the lender..

Due to the multiple taxation of dividends paid out of certain profits under the previous provision, Section 19 of CITA has been amended by the introduction of a new subsection to exclude certain profits from the excess dividend tax rule. These exclusions include retained earnings that have been subjected to tax, tax – exempt income, franked investments income , and distributions made by a real estate investment company to its shareholders from rental income and dividend received on behalf of those shareholders.

Quoted from
Exemption of Profits from Excess dividend Tax Rule

Tax Identification Number

It is now a statutory requirement that all companies have a Tax Identification Number (TIN) which must be exhibited on all business transactions with other companies and individuals, and on all documents, statement of returns, audited account and correspondences with revenue Authorities. For the purpose of expanding the tax net in Nigeria, banks are now required to request for the TIN of companies as a precondition for opening a bank account. For existing accounts, the bank is to require from companies their TIN for these accounts to continue to be operational.

Taxation of non -resident companies

The Act also focuses on closing the gaps in the applicable tax rules which govern foreign entities deriving income from trading activities that occur in Nigeria. A new paragraph (c) has been introduced to Section 13 of the CITA such that a foreign company will be subject to tax on profit made from Nigeria where "it transmits, emits or receives signals, sounds, messages, images or data of any kind by cable, radio, electromagnetic or wireless apparatus to Nigeria in respect of any activity, including electronic commerce, application store, high frequency trading, electronic data storage, online adverts, participative network platform, online payments and so on to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity. The question as to what constitute a "significant economic presence" is to be determined by the Minister in charge of finance through ministerial guidelines.

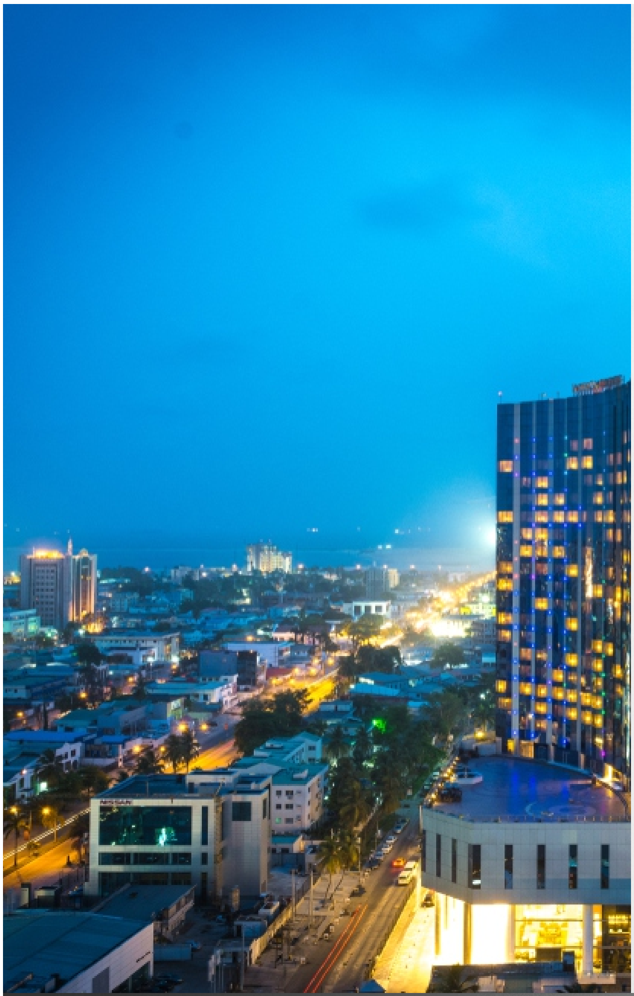
Accordingly, the profits derived by non-resident digital businesses from online activities, such as advertising, movie streaming, online gaming stores, e-commerce, etc., from their users/subscribers in Nigeria will now come within Nigeria's fiscal net, where so determined by the Minister. It is no longer enough for such entities to show that they do not have a fixed base or that they do not habitually carry on trade or stock an inventory in Nigeria.

Likewise, a foreign company which provides technical, management, consultancy or professional services outside Nigeria to a person resident in Nigeria to the extent that the company has significant economic presence in Nigeria will be subject to tax on profit made from that service.

Prior to the enactment of the Finance Act, the generally applicable CIT rate in Nigeria was 30% of taxable profits.

The new law stratifies companies into small, medium and large companies for the purpose of determining what tax rates should apply to them.

Quoted from **Introduction of a progressive CIT System**

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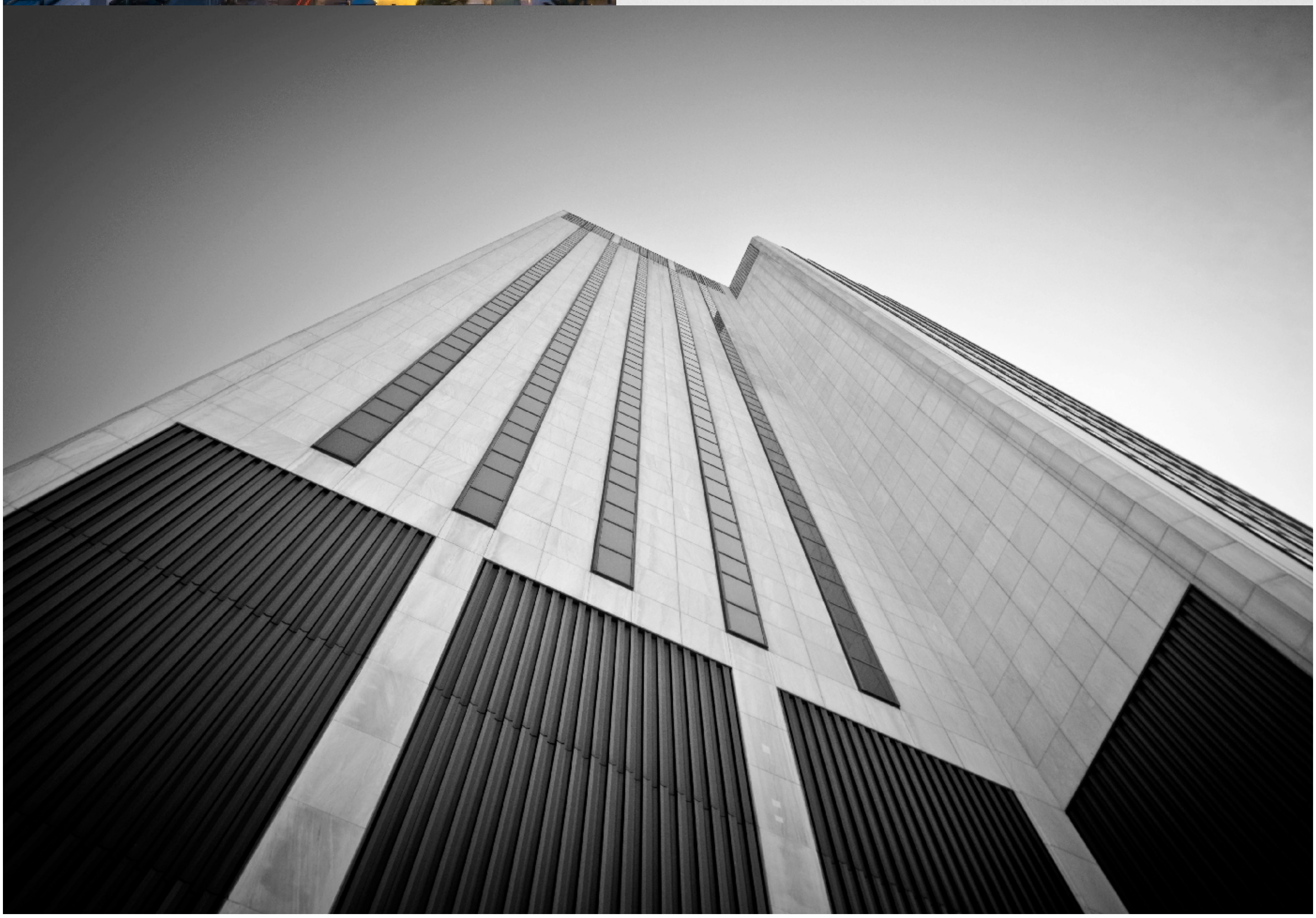

Taxation of Insurance Companies

The Act also addresses the double taxation of insurance companies. Unlike under the erstwhile fiscal framework where insurance companies, other than life insurance companies, allowed limited deductions of 45% and 25% of the total premium booked as reserves in cases of general insurance business and marine cargo insurance respectively, the Finance Act now allows for deduction (as reserve) from an insurance company's total / gross premium. As opposed to the former provision which allowed insurance companies to make deductions to a limit of 25% in respect of other reserves, claims and outgoings, the Finance Act allows insurance companies to make deductions of the estimated amount of all outstanding claims and outgoings for tax purposes.

The Act now provides that the tax payable by an insurance company for a year of assessment shall not be less than 0.5% of the gross premium or gross income for non-life insurance and life assurance businesses respectively.

The clause that limits the carrying forward of a loss to four years of assessment has been deleted. This implies that like all other companies, insurance companies may now carry losses forward in perpetuity.

Exemption of Profits from Excess dividend Tax Rule

Section 19 of CITA has been amended by the introduction of a new subsection to exclude certain profits from the excess dividend tax rule. These exclusions include retained earnings that have been subjected to tax, tax – exempt income, franked investments income, and distributions made by a real estate investment company to its shareholders from rental income and dividend received on behalf of those shareholders. Companies are therefore encouraged to properly track the sources of their declared dividends in order to enjoy the exemptions.

The new Act now includes "electronic mail" as an acceptable form of correspondence for persons disputing assessments by the Tax Authorities.

The Act also removes the requirement to obtain approval from the FIRS as a pre-condition for claiming contributions made to a pension, provident and other retirement benefits fund as a tax deductible expense.

Quoted from **Personal Income Tax Act**

Thin capitalization and base erosion

CITA has also been amended to curb Base Erosion and Profit Shifting as proposed by the Organisation for Economic Cooperation and Development (OECD). Thin capitalization refers to a situation where the capital of a company is heavily debt based when compared to the equity capital of the company. Investors, whether foreign or local, are inclined to structure thier investment as debt rather than as equity where the income tax laws are more favourable to recipients of interests than to recipients of dividends. Thin capitalization may hence be utilized to erode a tax base from an area of higher taxes to an area of lower taxes.

The Finance Act has attempted to provide rules to prevent profit shifting or erosion by disallowing the deduction of excess interest where a Nigerian company or a foreign company with a fixed base in Nigeria incurs interest in respect of debt from a foreign connected person. Excess interest has been defined by the Act to mean interest in excess of 30% of EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). A connected person is a person controlled by or under a common control, ownership or management as the Nigerian borrowing company; or a person who though not connected to the borrowing company but receives an implicit or explicit guarantee or deposit for the provision of corresponding or matching debt; a connected party will also mean a related party as provided under the Nigerian Transfer Pricing Regulations 2018.

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> **Thin capitalization and base erosion**

Introduction of a progressive CIT System

Prior to the enactment of the Finance Act, the generally applicable CIT rate in Nigeria was 30% of taxable profits.

The new law stratifies companies into small, medium and large companies for the purpose of determining what tax rates should apply to them. Small companies are companies with less than N25 million in annual turnover and are charged Zero CIT. Medium-sized companies are companies with revenues between N25m and N100m, and their CIT has been reduced from 30% to 20%. Large companies, defined by the Act as companies with annual turnover greater than N100m, will continue to pay the standard 30% CIT.

Value Added Tax (VAT) Act

Increase in VAT Rate

Driven by the need to align with global best practice and improve the efficiency of the Nigerian VAT system, the Finance Act raises VAT rate from 5% to 7.5%. Nigeria's increased new VAT rate of 7.5% still stands as the lowest in Africa, and one of the lowest in the world. (South Africa VAT: 15%; Ghana: 12.5%; Kenya: 16%; Egypt: 14%; Rwanda: 18%; Senegal: 18%). The new law has taken particular care to reduce the impact of the increase on the poor as basic goods and social services (food, drugs, education and healthcare, micro-finance banking) are exempt from VAT.

The Finance Act has also introduced a new VAT compliance threshold. Companies with an annual turnover of N25Million or less are exempt from registering for VAT, charging the tax, rendering monthly return of its sales and purchases and from the penalties prescribed by the Act for non-compliance with the administrative provisions.

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The Act also removes the requirement to obtain approval from the FIRS as a pre-condition for claiming contributions made to a pension, provident and other retirement benefits fund as a tax deductible expense.

Quoted from **Personal Income Tax Act**

Scope of VAT

Section 2 of the VAT Act has been re-enacted to clarify the scope of application of VAT. Formally, the provision only states that VAT will be charged and payable on the supply of all goods and services, other than those exempted. By virtue of the new provision, goods are deemed supplied in Nigeria if the goods are physically present in Nigeria at the time of supply, imported into Nigeria for use by a person, assembled in Nigeria or installed in Nigeria. Where the beneficial owner of the rights in or over the good is a taxable person in Nigeria and the goods or right is situated, registered or exercisable in Nigeria, the goods will be deemed supplied in Nigeria. Services will be subject to VAT when rendered in Nigeria by a person physically present in Nigeria at the time the service is provided; or where the services are provided to a person in Nigeria regardless of whether the services are rendered within or outside Nigeria.

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Personal Income Tax Act

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Banks are now obligated to require from a person intending to open a bank account for the purposes of the person's business operations to provide a Tax Identification Number ("TIN") as a precondition for opening or continue operating of such bank account.

Stamp Duty Act

With the new Act, the N50 Stamp duty charge is now applicable only to transactions amounting to N10,000 and above, a significant increase on the former threshold of N1,000.

The new Act also expands the list of items exempted from stamp duty.Expansion of the definition of receipt to cover electronic transactions. This broadens the application of stamp duties.

Customs and Excise Tariff Act

To reduce unfair advantages previously conferred on imported goods at the expense of locally manufactured ones, certain imported goods are now subject to excise duties similar to locally manufactured goods.

Petroleum Profits Tax Act

Prior to the Finance Act, no further tax was assessable or payable on any income or dividends paid out of any profits for which Petroleum Profits Tax has been paid. However, in order to subject dividends paid out of petroleum profits to withholding tax, section 60 of the Petroleum Profits Tax Act has been deleted.

Conclusion

Altogether, the Finance Act is a bold legislative attempt to ensure economic stability by fostering entrepreneurship and economic growth in the country while closing existing gaps in the erstwhile fiscal framework. These gaps have resulted in substantial revenue losses to the government.

The Act also introduces new concepts and protocols, which are yet to be tested. Furthermore, how the Minister will interpret "significant economic presence" will no doubt impact the rights and obligations of foreign companies who otherwise have no connection with Nigeria. That said, the Act is substantially drafted as an amendment to various provisions of disparate legislation, and therefore cannot be understood without recourse to the distinct laws that the Act seeks to modify.

All of the foregoing makes expert guidance absolutely indispensable in any attempt to conflate the provisions of the Finance Act with the laws it seeks to amend.

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