TEMPLARS Transcripts: Tax Digest

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Policy and Tax Administration

1. Federal Inland Revenue Service (FIRS) Circular on Tax Treatment of Foreign Exchange Transactions

On 14 June 2024, the FIRS issued a circular explaining the applicable tax treatment of foreign exchange transactions. In the circular, the FIRS recognized the International Financial Reporting Standards (the Standards) prescribed for the treatment of foreign currency transactions and noted that though sufficient for accounting purposes, the Standards are not in line with the provisions of the tax laws. Based on this, the FIRS through the circular clarified the relevant adjustments required to determine the tax position of an entity following a foreign exchange transaction in line with the relevant tax laws.

According to the circular, when a transaction is conducted in foreign exchange, a foreign exchange difference (i.e., a loss or gain) may arise where the exchange rate used in booking the transaction differs from the rate used subsequently in reporting or settling the transaction.

The circular classifies foreign exchange differences into two (depending on the nature of the underlying transaction), namely:

a) Revenue difference, i.e. foreign ***exchange gains or losses arising from income-generating transactions,*** and

b) Capital difference, i.e. foreign ***exchange gains or losses arising from non-revenue generating transactions*** such as purchase of assets, borrowing, loan repayment, etc.)

The circular further classifies foreign exchange difference as realized and unrealized depending on whether the sum resulting in the difference (i.e., gain or loss) has been actually paid or received.

Below are highlights of the clarifications provided by the FIRS:

- Revenue exchange difference will be accounted for in ascertaining the assessable profit or income of an entity for income tax purpose while capital exchange difference will be accounted in ascertaining the amount of capital gains for capital gains tax purposes.

- Unrealized exchange differences[1] do not increase or decrease the tax liability as they must be ignored in the computation of the assessable profits.[2] However, realized exchange differences would either increase (in the case of a gain) or decrease (in the event of a loss) tax due as they are included in the computation of the assessable profits.

- Where a revenue difference is realized as a gain it will be included in the assessable profit of the entity before subjecting same to tax, whereas if it is realized as a loss, the amount will be deducted from the assessable profit of the entity before subjecting same to tax.

- Where a capital difference is realized as a gain, it will be treated as a capital exchange gain and will be subject to capital gains tax at the prevailing CGT rate whereas, where a capital difference is realized as a loss it will not be deducted as a loss but will be added to the cost of the assets, in the year that the loss becomes realized, for the purpose of capital allowances.

- Exchange differences on foreign currency cash balances are unrealized upon conversion to another currency or another class of monetary or nonmonetary item. The implication of this is that any difference arising from the conversion of a foreign currency cash balance will not be taxable in the case of a gain or deductible in the case of a loss.

- Exchange differences arising from items exempt from tax are also not taxable in the case of a gain, and not deductible in the case of a loss.

- Unrealized differences recognized for accounting purposes shall not be adjusted in computing the following taxes;

    a) National Agency for Science and Engineering Infrastructure (NASENI) levy at 0.25% of the profit before tax
    b) National Information Technology Development Agency (NITDA) Levy at 1% of profit before tax, and
    c) Minimum tax payable under section 33(2) of CITA at the rate of 0.5% of gross turnover.

    The implication of this is that unrealized gains or profit will not be ignored in ascertaining the profit of the company for the above tax purposes.

[1] Whether revenue or capital difference.

- The nature of a taxpayer's ordinary business is a key factor in the classification of foreign exchange transactions. For example, while an exchange difference from a long-term loan granted by a bank to a customer to finance the purchase of a new plant will be treated as revenue for the bank,[3] the exchange difference on the same transaction will be classified as capital in the hand of the customer.

2. Federal Government pushes for harmonization of NIN and TIN to combat tax evasion.

In a bid to checkmate tax evasion in Nigeria, the Federal Government through the Minister of Interior (the "**Minister**") has proposed the harmonization of the National Identification Number (NIN) and the Tax Identification Number (TIN).

The aim of the proposed harmonization is to ease access to information to achieve more taxable income for the government and eliminate tax evasion.

Although the Minister noted that many expatriates evade tax at the state and federal level, it is unclear how the harmonization will help resolve the issue considering that expatriates do not have NINs. In the interim we anticipate a collaboration between the JTB and the Nigerian Immigration Service that will link NIN of individual taxpayers to their TIN.

3. Proposed Reforms by the Presidential Tax and Fiscal Policy Reforms Committee

The Presidential Tax and Fiscal Policy Reforms Committee (the "**Committee**") recently proposed reforms to the value added tax rate, the exchange rate for payment of customs import duty and the revenue collection costs of the Federal Inland Revenue Service (FIRS), Nigeria Customs Service (NCS), and other revenue-generating agencies. The details of the proposed reform are as follows:

- **New VAT and CIT rates to be carried out in phases**

  On 3rd June 2024, the chairman of the Committee, Mr. Taiwo Oyedele (the "**Chairman**") announced a proposed review of the Value Added Tax (VAT) tax rate from 7.5% to 10%, to be undertaken in phases. This disclosure was made while speaking at a public consultation workshop for journalists and public analysts held in Abuja.

  Notably, VAT is a consumption tax administered by the Federal Inland Revenue Service on all goods purchased, and services rendered in Nigeria other than those exempted. Previously under the VAT Act, the VAT rate was 5%. However, this was amended by the Finance Act 2021, increasing the rate from 5% to 7.5%, which took effect on 1 February 2020. According to the Committee, the proposed review is hinged on an empirical data which confirmed that less than 10% of affluent Nigerians fulfil their obligations to pay the accurate amount of taxes due to the government.

[2] This is to say that if a difference (i.e., gain or loss) is unrealized it will be treated as non-existent for the purposes of tax computation to avoid any tax implication.
[3] This is because granting of loan is in the ordinary course of business of a bank and qualifies as an income generating transaction.

While the VAT rate adjusts upwards, CIT rate will adjust downwards as the proposed reform will also reduce the Company Income Tax (CIT) rate from 30% to 25%, which will also be implemented in phases. For instance, it could be reduced to 27.5% in 2025 then to 25% in 2026. The choice of implementing the change in phases is to prevent an impact on government revenue. Pending the implementation of the phase review, the Chairman also stated that the law providing these reviews will first be passed and would give directive on what rate is to be paid in the future.

Further, the Chairman clarified that the reform would also involve a review of the revenue-sharing formula by increasing state collection rate from 50 per cent to 55 per cent, local government area to 35 percent and reduction of the federal government to 10 per cent.

The new tax rates have not yet been implemented. However, in the meantime, taxpayers should anticipate the enactment of a proposed legislation and directive providing the new tax rates and how they are to be implemented in phases.

- **₦800/$ Exchange Rate for Customs Duties**

The Committee has announced its recommendation to the Federal Government, for the adoption of ₦800 per dollar as the exchange rate for payment of customs import duty for the rest of the year 2024. This announcement was made by the Chairman of the Committee, Mr. Taiwo Oyedele, while engaging journalists on the activities of the tax panel in Lagos earlier this month.

The recommendation was necessitated by the recent adjustments made by the Nigerian Customs Service (the "**NCS**") of the foreign exchange (FX) market rates for tariffs and duties, pegging the rate at N1,480 per dollar.

According to Mr Taiwo Oyedele, constant changes to the exchange rate due to the volatility of the foreign exchange (FX) market, affects adequate planning for business as well as the government. The Federal Government adopting the proposal will bring the much-required stability to tariffs and duties, allowing businesses to make adequate plans.

Additionally, the Director-General of the Centre for the Promotion of Private Enterprise (the "**CPPE**"), Muda Yusuf, also suggested that the NCS should adopt a quarterly exchange rate for import duties assessment to give businesses certainty and predictability, instead of a fixed rate.

- **Reduction of FIRS and Customs' Revenue Collection Costs to 1%**

The Committee has announced it is considering a policy to slash the revenue collection costs of the Federal Inland Revenue Service (FIRS), Nigeria Customs Service (NCS), and other revenue-generating agencies to 1%. This move aligns with international benchmarks and is poised to significantly boost government income for project financing.

Currently, Nigeria's revenue collection costs are markedly higher than the global average, with FIRS and NCS retaining 7% and 4% of non-oil tax receipts, respectively. This stands in stark contrast to countries like South Africa, where revenue collection costs are less than 1%. Mr. Taiwo Oyedele, the Chairman of the

Committee emphasized that the proposed reduction is not only feasible but necessary for efficient and effective revenue mobilization.

Overall, the proposed tax and fiscal reforms represent a monumental shift in Nigeria's approach to revenue collection and fiscal policy. By cutting down the cost of revenue collection and restructuring tax laws, the committee aims to create a more efficient, equitable, and prosperous economic landscape.

4. Benue State Government Offers Investors Tax Holidays

The Benue State Government has introduced a one-stop shop to ease of doing business and offered tax holiday to incentivise investors interested in investing in the state. This was disclosed by the managing director of Benue Investment and Property Company (BIPC), Dr Raymond Asemakaha, during a meeting with representatives from the Nigerian Brewery at the BIPC corporate headquarters in Makurdi.

Dr Raymond Asemakaha expressed the eagerness of the Benue State Government to see companies operating at full scale within the state noting that the state is rich in raw materials and the workforce to support investment operations. However, he did not disclose any details on the length of the tax holiday.

5. Federal Inland Revenue Service Files Charges Against Property Firm for Alleged Tax Evasion

The Federal Inland Revenue Service ("**FIRS**") has initiated legal proceedings against Well Property Development Company Limited, a Lagos-based property firm. The suit which was filed on behalf of the Federal Republic of Nigeria before the Federal High Court, Abuja, names Well Property Development Company Limited and nine other persons as defendants.

The charge against the company comprises failure to file accurate and complete income tax returns in the prescribed manner, furnishing the FIRS with false information regarding the company's income, wilfully evading tax assessment and payment, and remittance of tax to the federal government, failure to deduct and remit all relevant taxes and making false declarations on tax returns for the years 2019 to 2022.

The charge filed by the FIRS underscores FIRS' fight against tax evasion in recent times. This is coming on the heels on FIRS charges against Binance Holdings Limited executives for tax evasion. It will appear that the FIRS has reinforced its fight against tax evasion and related tax offences especially following its collaboration with the Independent Corrupt Practices and Other Related Offences Commission (ICPC) to tackle cases of tax evasion and financial crime in Nigeria.

Legislative Advancements

1. Withholding Regulations 2024

On 1 July 2024, the Minister of Finance and Coordinating Minister of the Economy, Mr. Adebayo Olawale Edun, issued the Deduction at Source (Withholding Tax) Regulation 2024 (the "**Regulations**") pursuant to Section 81(9) of the Companies Income Tax Act (CITA), Section 56 of the Petroleum Profit Tax Act (PITA), and Section 73(6) of the Personal Income Tax Act (PITA).

The Regulations, which became effective on 1 July 2024, sets out the rules for deduction of tax from payments made to taxable persons under the Capital Gains Tax Act, Companies Income Tax Act, Petroleum Profits Tax Act, and the Personal Income Tax Act.

The Regulations introduced new provisions which did not exist in the previous WHT regime. Below are highlights of new provisions introduced by the Regulation.

- Expansion of eligible transactions: The Regulations extended the application of WHT to payments in transactions relating to amongst others, co-location and telecommunication tower services, construction of power plant, compensation for loss of employment, entertainers and sportspersons, winnings from lottery, gaming, reality shows and supply or rendering of services other than those specifically listed in the Schedule to the Regulations.[4]

- Expansion of categories of persons required to deduct tax at source to include any other institution, organization, establishment or enterprise exempted from tax and payment made by agent on behalf of eligible persons.[5]

- Exemption of small companies[6] from deducting WHT at source provided that (a) the supplier has a valid Tax Identification Number, and (b) the value of the transaction is NGN2,000,000.00 (Two Million Naira) or less during the relevant calendar month.[7]

- The obligation to deduct at source shall arise at the earlier of when payment is made or the amount due is otherwise settled. And in the case of payment between related parties, deduction shall be deemed to be made at the time of payment or when the liability is recognised, whichever is earlier.[8]

- The period for remittance of deduction is as follows,

  (i) where it is to be made to the Federal Inland Revenue Service, not later than the 21st day of the month following the month of payment
  (ii) where it is made to the State Internal Revenue Service,

[4] Regulation 1 of the Regulation
[5] Regulation 2(1) of the Regulation.
[6] Section 105 of Companies Income Tax Act (as amended) defines a small company to mean a company that earns gross turnover of ₦25,000,000 or less.
[7] Regulation 2(2) of the Regulation.
[8] Regulation 4 (1) & (2) of the Regulations.

(a) not later than the 10th of the month following the payment in the case of Capital Gain Tax and Pay-As-You-Earn and
(b) not later than the 30th day of the month following the month of payment with respect to any other deduction.[9]

- Where a person required to deduct at source fails to do so and pays the portion of the required deduction to the recipient, only an administrative penalty and a one-off annual interest on the amount not deducted shall be payable as penalty.[10] This provision contemplates a situation where a person obligated to deduct inadvertently paid the portion of the deduction to the recipient of the payment.[11]

- Where a person obligated to deduct at source issues a receipt for any amount so deducted but yet to be remitted to the relevant tax authority, the beneficiary i.e., recipient of the receipt will be credited by the relevant tax authority and the amount unremitted shall be treated as the tax liability of the person who made the deduction and shall be recoverable with applicable penalty and interest.[12]

- For eligible transactions involving non-passive income, the amount to be deducted at source shall be twice the rate specified in the schedule where the recipient has no tax identification number (TIN). This provision seeks to deter non-compliance with obligation to register and obtain a TIN. However, we note that the provision may be subject to challenge on the basis that the principal legislations already contain a penalty for non-compliance.

- **Transactions Exempt from Deduction at Source**

  Previously, the applicable WHT regime only exempted contracts for sale in the ordinary course of business. The Regulations now provides a list of additional transactions exempted from WHT deduction. These transactions include:

  a. Compensating payments under a Registered Securities Lending Transaction, per section 81(8) of the Companies Income Tax Act.
  b. Distribution or dividend payments to a Real Estate Investment Trust or Real Estate Investment Company as specified in section 80(5) of the Companies Income Tax Act.
  c. Across-the-counter transactions[13].
  d. Interest and fees paid to a Nigerian bank via direct debit of funds domiciled with the bank.
  e. Goods manufactured or materials produced by the supplier.
  f. Imported goods where the transaction does not create a taxable presence in Nigeria for the foreign supplier.
  g. Payments in respect of income or profit exempt from tax.

[9] Regulation 5 (1) of the Regulations.
[10] Regulation 7 (2) of the Regulation
[11] Notwithstanding, the penalty under section 74 of Personal Income Tax Act and Section 40 of the FIRS Act applicable to persons who outrightly fails to deduct or having so deducted fails to remit to the relevant tax authority still subsists.
[12] Regulation 6 (3) of the Regulations.
[13] Across-the-counter transactions means any transaction carried out between parties without an established contractual relationship or any prior formal contracting arrangement and in which payment is made instantly in cash or on the spot via electronic means – Paragraph 9(b) of the Regulations.

h. Out-of-pocket expenses normally incurred directly by the supplier and distinguishable from contract fees.
i. Insurance premiums.
j. Supply of Liquefied Petroleum Gas (LPG), Compressed Natural Gas (CNG), Premium Motor Spirits (PMS), Automotive Gas Oil (AGO), Low Pour Fuel Oil (LPFO), Dual Purpose Kerosene (DPK), and JET-A1.
k. Commissions retained by brokers from monies collected on behalf of the principal, in line with industry norms.
l. Winnings from a game of chance or a reality show with contents designed exclusively to promote entrepreneurship, academics, technological or scientific innovation.

The Regulation is an upshot of the ongoing fiscal policy and tax reforms undertaken by the Presidential Fiscal Policy & Tax Reforms Committee and has introduced laudable changes in the Nigerian withholding tax regime.