THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

PROFESSIONAL EXAMINATION

PTE II: INCOME TAX FOR SPECIALIZED BUSINESSES

EXAM NO………………………..…………………………..…. **TIME: 3 HOURS.**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS

SHOW ALL WORKINGS.

1. (a) Oku Iboku Petroleum Company Limited has been in the oil and gas business for several years. During the year ended December 31, 2018, the company supplied natural gas to two companies based in Togo and Liberia.

Contract	Load Factor	Value (₦)
1	65^0	7,000,000
2	78^0	3,000,000

The Managing Director of the company would like to be advised on the assessable amount of the two contracts and the applicable tax.

You are provided with the table below:

Load Factor	**G-Factor per centum**
50^0	16.9
60^0	15.5
70^0	14.3
100^0	13.6

Required:

(i) Define the term chargeable natural gas. (1 Mark)

(ii) Define the value of chargeable natural gas. (2 Marks)

(iii) Calculate the value of gas sold for tax purposes and the applicable tax liability. (4 Marks)

(iv) State any Four (4) incentives available to a company engaged in the utilisation of associated gas. (8 Marks)

(b) The profit and loss of the South-South Oil Company (Nigeria) Limited, a petroleum exploration company, for the year ended December 31, 2018 recorded a turnover of ₦38,840,000 and a net profit of ₦25,280,000. In arriving at the net profit, items (i) to (x) below were taken into account:

		₦
(i)	Clearing of oil spillage	1,600,000
(ii)	Profit on sale of fixed assets	8,000
(iii)	Depreciation	500,000
(iv)	Cost of drilling 5 appraisal wells in a particular field (₦600,000 per well)	3,000,000
(v)	Royalties	1,840,000
(vi)	Custom duties	45,000
(vii)	Income from transportation of crude oil to USA for other oil companies	3,800,000
(viii)	Expenses relating to the business of transportation of crude oil	1,200,000
(ix)	Donations	700,000
(x)	Community relations expenses	1,500,000

Additional information:

Capital allowances on petroleum operations brought forward	8,100,000
Annual allowance on petroleum operations	5,520,000
Balancing charge on petroleum operations	66,000
Petroleum investment allowance	3,425,000
Losses on petroleum operations brought forward	7,800,000
Intangible drilling expenses capitalised during the year	2,700,000

Required:

Compute the tax liability of the company for the relevant accounting period.

(25 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) (i) Chargeable natural gas

In relation to a company engaged in petroleum operations, chargeable natural gas means natural gas actually delivered by such company to Nigerian National Petroleum Corporation under a Gas sales contract but does not include natural gas taken by or on behalf of the government of the federation in pursuance of petroleum Act.

(ii) Value of chargeable natural gas

The fourth schedule to the petroleum profits Tax Act states that the value of all chargeable natural gas in the accounting period shall be the sum of gross proceeds under individual gas sales contracts in the accounting period less the G-factor allowance as applicatble to individual gas sales contract at the appropriate rate per cost of such proceeds under any such individual gas sales contracts.

(iii) Computation of value of natural gas sold

Contract 1: G-factor Allowance

The load factor of 65° lies between the G-factors of 60° and 70°, therefore, G-factor 65° is calculated as follows:

$15.5 – (15.5 – 14.3) \text{ x } {}^{65}/_{70} – {}^{60}/_{60})$

$15.5 – (1.2 \text{ x } {}^{5}/_{10})$

$15.5 – 0.6 = 14.90\%$

G-factor allowance = 14.90% x N7,000,000 = N1,043,000

Contract 2: G-factor Allowance

The load factor of 78° lies between the G-factors of 70° and 100° therefore the G-factor of 78° is calculated as follows:

$14.3 - (14.3 - 13.6) \times {}^{78}/_{100} - {}^{70}/_{70})$
$14.3 - (0.7 \times {}^{8}/_{30})$
$14.3 - 0.19 = 14.11\%$
G-factor allowance = 14.11% x N3,000,000 = N423,300

Value of natural has sold

Contract	Gross Proceeds	G-factor Allowance	Net Proceeds
1	N7,000,000	N1,043,000	N5,957,000
2	N3,000,000	N423,300	N2,576,700
	N10,000,000	N1,466,300	N8,533,700

Company Income Tax (30% of N8,533,700) = N2,560,110
Tertiary Education Tax (2% of N8,533,700) = N170,674

(iv) Tax incentives for the Utilisation of Associated Gas.
Under section 39 of CITA, a company engaged in gas utilisation (downstream operations) shall be granted the following incentives:

(a) An initial tax free period of three years which may, subject to the satisfactory performance of the business be renewed for an initial period of two years.
(b) An additional investment allowance of 35% which shall not reduce the value of the asset as an alternative to the initial tax free period under (a) above and the incentive provided under (c)(ii) below;
(c) Accelerated capital allowances after the tax free period as follows:
    (i) An annual allowance of 90 percent with 10 percent retention for investment in plant and machinery; and
    (ii) An additional investment allowance of 15 percent which shall not reduce the value of the asset.
(d) Tax free dividends during the tax free period where:
    (i) The investment for the business was in foreign currency; or
    (ii) The introduction of imported plant and machinery during the period was not less than 30 percent of the equit share capital of the company.
(e) Interest payable on any loan obtained with the prior approval of the minister for a gas project shall be tax deductible.

The tax free period of a company shall start on the day the company commences production as certified by the ministry of Petroleum Resources. Section 11 of PPTA 2004 provides that the following incentives shall apply to a company engaged in the utilisation of associated gas:

(f) Investment required to separate crude oil and gas from the reservoir into usable products shall be considered as part of the oil field development;
(g) Capital investment on facilities equipment to deliver associated gas in usable form at utilisation or designated custody transfer points shall be treated for tax purposes, as part of the capital investment for oil development;
(h) All capital investments relating to the gas to liquids facilities shall be treated as chargeable capital allowance and recovered against the crude oil income; and
(i) Gas transferred from the natural gas liquid facility to the gas to liquids facilities shall be at zero percent tax and zero percent royalty.

(b) South-south oil company (Nigeria) Limited
Computation of Petroleum Profits tax for the Accounting period ended December 31, 2018.

	₦	₦
Net profits as per accounts		25,280,000
Add: Balancing charge		66,000
		25,346,000
Add: Disallowable expenses:		
Depreciation	500,000	
Cost of drilling 3 appraisal wells (3 x 60,000)	1,800,000	
Expenses of transportation of crude oil	1,200,000	
Donations	700,000	4,200,000
		29,546,000
Less:		
Profit on sale of fixed assets	8,000	
Income from transportation of crude oil	3,800,000	
Intangible drilling expenses	2,700,000	6,508,000
Adjusted profit before education tax		23,038,000
Tertiary education tax (sec W1)		298,784
Adjusted profit after tertiary education tax		22,739,216
Less losses brought forward		7,800,000
Assessable profit		14,939,216
Less capital allowance – lower of:		
Capital allowances brought forward	8,100,000	
Annual allowance for the year	5,520,000	
Petroleum investment allowance	3,425,000	
	17,045,000	
And		
85% of assessable profit (i.e. 85% of 14,939,216)	12,698,334	
Less 170% of PIA (i.e. 170% of 3,425,000)	5,822,500	
Capital allowances relieved	6,875,834	6,875,834
Capital allowances carried forward	10,169,166	
Chargeable profit		8,063,382
Assessable tax = 85% of chargeable profit (85%x8,063,382)		6,853,875
Chargeable tax		6,853,875

Companies Income Tax

The company is also liable to companies income tax on the profits from transportation business:

	₦
Income from transportation of crude oil to USA	3,800,000
Expenses of transportation crude oil	1,200,000
Assessable profit from transportation business	2,600,000
Companies Income tax (30% x 2,600,000)	780,000
Tertiary education tax (2% x 2,600,000)	52,000

Workings:

W1- Tertiary Education Tax on Petroleum Operations

Adjusted profit before tertiary education tax	23,038,000
Less loss relief	7,800,000
Assessable profit before tertiary education tax	15,238,000
Tertiary education tax $\frac{2}{100+2}$ x 15,238,000 =	298,784

EXAMINER'S REPORT

The question tests candidate's knowledge of the Petroleum Profit Tax. All the candidates attempted the question and performance was poor as only 2% of the candidates that attempted the question scored above average mark obtainable.

The commonest pitfall for most candidates was lack of understanding of the provisions of the Petroleum Profit Tax Act.

Candidates are advised to adequately cover all sections of the syllabus for better performance in future examinations.

2. Through its circular issued in May 2019, the National Insurance Commission (NAICOM) reviewed upward the minimum paid-up capital requirements of insurance and reinsurance companies in Nigeria. The new capital requirements are ₦8billion, ₦10billion, ₦18billion and ₦20billion for life insurance companies, general insurance companies, composite insurance companies and reinsurance companies respectively. Existing insurance and reinsurance companies are obliged to fully comply with the minimum paid-up capital requirements not later than June 30, 2020. However, in another circular dated December 30, 2019, the Commission has extended the recapitalisation deadline to December 31, 2020.

   Since then many insurance companies have made efforts to meet the recapitalisation deadline. Some insurance companies are in the process of raising additional capital through the Nigerian Stock Exchange, while some others have signed Memoranda of Understanding (MOU) with other insurance companies to facilitate their proposed mergers and acquisitions.

   The management of African Insurance Plc. Solid Rock Insurance Company Limited and Lion Heart Insurance Company Limited have announced merger plans involving the three insurance companies. Consequently, they have set up a Joint Committee to fine-tune the merger arrangement.

   You are required to:
   Offer an advice to the Chairman of the Joint Committee on Merger of the three companies on the tax implications of the proposed merger:

   (a) Assuming that the merger would result in the formation of a new insurance company to take over the three old companies; and
   (b) Assuming that the merger would result in the survival of one of the merging companies to inherit the assets, liabilities and operations of the other companies.

   (15 Marks)

SOULTION TO QUESTION 2

John Bosco-Co Tax Consultants
No, 30 Emmanuel Street,
Alapere,
Lagos
13th January, 2019

The chairman,
Joint Committee on Merger Scheme,
African Insurance Plc,
No 44, Board Street,
Lagos

Dear Sir,

TAX IMPLICATIONS OF THE PROPOSED MERGER OF AFRICAN INSURANCE PLC, SOLID INSURANCE COMPANY LIMITED AND LION HEART INSURANCE COMPANY LIMITED

We refer to your request for our advice on the above subject matter and wish to respond as follows:
Preamble.
Section 29(12) of the Companies Income Tax Act, 2004 provides that no merger, take-over, transfer or restructuring of the trade or business carried on by a company can take place without having obtained the consent or direction of the Federal Inland Revenue Service (FIRS). We, therefore, advise the three insurance companies concerned to promptly bring the merger proposal to the notice of the FIRS with copies of the relevant schemes of merger and arrangement for evaluation. This will enable the companies and the FIRS to discuss and agree on tax matters and forestall the possibility of disagreement or dispute after the merger.

Tax implication of the merger

The tax implications of the merger will depend on the type of the particular arrangement effected by the companies and the result of such arrangement and whether the merging companies are related or not. The Companies Income Tax Act has not categorically addressed the tax issues of mergers, acquisition, etc. However, the Act has given the FIRS power to give direction on these issues so we have to rely mostly on the tax authority pronouncements.

(a) Merger resulting in the formation of a new insurance company:
  - (i) All the merging insurance companies will be deemed to have ceased business permanent by and the cessation provisions will apply to them.
  - (ii) The new insurance company will be deemed to have commenced business and the commencement rules will apply.
  - (iii) The new company that emerges from the merger process is expected to file its audited accounts and returns with the FIRS within eighteen months from the date of its incorporation or not later than six months after the end of its first accounting period, whichever is earlier.
  - (iv) The new company will not be entitled to any initial allowance. It will only be entitled to claim annual allowance on the tax written down values (TWDV) of the transferred assets.
  - (v) The unrelieved losses and capital allowances of the individual merging companies may not be allowed to be carried forward and set off against the assessable profits of the company after the merger.
  - (vi) Stamp duty payment will arise on the share capital of the new company.
  - (vii) Fees paid to statutory bodies such as Securities and Exchange Commission (SEC), Nigerian Stock Exchange (NSE), etc and professionals like accountants, stockbrokers, issuing houses and solicitors are regarded as capital in nature and will, therefore, not be allowed as deductible expenses.
  - (viii) Fees paid to professionals for services rendered in connection with consolidation will be subject to value added tax (VAT) and withholding tax (WHT) at the rates 7.5% and 10% respectively.
  - (ix) The FIRS may require the new company to guarantee or give security for payment in full, for tax due or that may become due by any of the ceased companies.

(b) Merger resulting in the survival of one of the merging companies
  - (i) The surviving insurance company must file its returns as an existing company in line with the provision of CITA.

(ii) Commencement rules will not apply to the surviving company as it will be regarded as an existing company. The other companies absorbed will be deemed to have ceased business and the cessation rules will apply to them.

(iii) The surviving company will not be allowed to claim investment on the assets which were transferred to it and will also not claim initial allowance on such assets.

(iv) The surviving company may however claim annual allowance only on the tax written down values (TWDV) of the assets transferred to it.

(v) The surviving company may not inherit the unabsorbed losses and capital allowances of the merging companies for set off against its assessable profits after the acquisition.

(vi) All fees payable on merger bids or consolidation will be liable to VAT and WHT just like it is applicable on the emergence of a new company.

(vii) Stamp duties will be paid on the increase in share capital.

Should you require further explanation or clarification, please do not hesitate to contact us.
Yours faithfully,
For: John Bosco & Co. Tax Consultants
Ngozi Chukwu
Principal Consultant.

EXAMINER'S REPORT

The question tests candidates' knowledge of merger and acquisition and the tax implications thereof. Most of the candidates' attempted the question and performance was good.

Commonest pitfalls in the question were:

i. Candidates interpret tax implications as negative effects of tax when companies merged.
ii. Candidates outline rules guiding commencement and cessation of business.

Candidates are advised to adequately cover all sections of the Institute's syllabus to ensure better performance in future examinations.

3. Flying Eagles Limited is a foreign airline company and has been involved in the business of transporting passengers and goods to and from Nigeria since 2010. The financial results of the company's operation for the year ended December 31, 2018 are as follows:

	₦	₦
Income from cargo freight out of Nigeria		45,000,000
Income from cargo freight into Nigeria		30,000,000
Income from passenger freight out of Nigeria		20,000,000
Income from passenger freight into Nigeria		25,000,000
		120,000,000
Less expenses:		
Wages and salaries	34,800,000	
Depreciation	6,000,000	
Other expenses	17,200,000	58,000,000
Net profit		62,000,000
Additional information:		
Other expenses include:		
Income tax provision		7,000,000
General provision for bad debts		3,000,000
Donations to University of Abuja		1,200,000
Donations to political parties		2,000,000
Other disallowable expenses		4,000,000
		17,200,000

Note:
The Federal Inland Revenue Service (FIRS) has obtained satisfactory evidence that the basis adopted by the tax authority of the country in which the company is registered for the computation and assessment of profit or loss of companies engaged in airline business is not materially different from that used in Nigeria and the relevant ratios have been certified by the foreign tax authority.

You are required to compute:

(a) Company's adjusted profit. (5 Marks)

(b) Company's adjusted profit ratio and the depreciation ratio. (2 Marks)

(c) Total profits of the company for Nigerian tax purposes. (5 Marks)

(d) Tax liability of the company for the relevant year of assessment. (2 Marks)

(e) How would the company be assessed to Nigerian tax if the FIRS is not satisfied that the tax authority of the airline company's home country computes and assesses to tax the profits of an airline company on a basis not materially different from that prescribed by CITA? (1 Mark)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) Flying Eagles Limited.
Computation of adjusted profit for 2019 year of assessment

	N	N
Net Profit per account		62,000,000
Add: disallowable expenses:		
Depreciation	6,000,000	
Income tax provision	7,000,000	
General provision for bad debts	3,000,000	
Donations to political parties	2,000,000	
Other disallowable expenses	4,000,000	22,000,000
		84,000,000

(b) Computation of adjusted profit ratio and depreciation Ratio for 2019 YOA

Adjusted profit ratio (APR) = $\frac{\text{Global adjusted profit}}{\text{Global Income}} \times 100$

= $\frac{84,000,000}{120,000,000} \times 100$ = 70%

Depreciation Ratio (DR) = $\frac{\text{Global Depreciation}}{\text{Global Income}} \times 100$

= $\frac{6,000,000}{12,000,000} \times 100$ = 5%

(c) Computation of total profit liable to tax in Nigeria for 2019 YOA

Nigeria Income	N
Income from cargo freight out of Nigeria	45,000,000
Income from passenger out of Nigeria	20,000,000

				65,000,000
Nigeria adjusted profit	=	APR x Nigerian income		
	=	70% x 65,000,000	=	45,500,000
Nigerian capital allowance	=	DR x Nigerian income		
	=	5% x 65,000,000	=	3,250,000
				42,250,000

(d) Computation of tax liability

	₦
Income tax payable (30% of 42,250,000)	12,675,000
Minimum tax (2% x 65,000,000)	1,300,000

Note: The income tax payable by the company is ₦12, 675,000 since the income tax computed is higher than the minimum tax.

(e) If at the time of assessment the FIRS is not satisfied with foreign tax authority's basis of computing and assessing profits or loss, the FIRS may compute the profits deemed to be derived from Nigeria by applying a fair percentage to the full sum receivable in Nigeria in respect of the carriage of passengers, mails, good etc loaded into the company's aircrafts in Nigeria.

EXAMINER'S REPORT

The question tests candidates' knowledge on taxation of Airline Company in Nigeria. Most of the candidates attempted the question and performance was below average.

A great number of candidates could be said to have a good understanding of the question as a larger number scored above average and only few scored below average.

The commonest pitfalls was inability of the candidates to correctly calculate adjusted profit ratio (APR) and depreciation ratio (DR).

Candidates are advised to pay more attention to this area of the syllabus for better performance in future examinations.

4. The Industrial Development (Income Tax Relief) Act, Cap. 17, LFN 2004 makes provision for tax reliefs for certain companies that have been issued with pioneer certificates. In order to take advantage of the tax incentive, Solid Rock Cement Limited was incorporated on October 1, 2014, to manufacture cement and was granted a pioneer certificate for three years with its production day certified as January 1, 2015. At the end of the pioneer period, the company continued in business and adopted September 30, as its year-end.

You have been provided with the following information:

		₦'000
(a)	Accumulated losses as at 31/12/2017	300,000
(b)	Adjusted profits for the 9 months ended 30/9/2018	102,000
(c)	Adjusted profits for the 12 months ended 30/9/2019	1,080,000
(d)	Capital expenditure incurred during the pioneer period:	
	Buildings	850,000
	Plant and Machinery	700,000
	Motor vehicles	750,000
	Furniture	250,000

All the capital expenditure and the losses were certified by the Federal Inland Revenue Service (FIRS).

During the pioneer period, the company imported the same product for which it was granted pioneer status and made profits of ₦900,000,000 and ₦800,000,000 for the years ended December 31, 2015 and 2016.

Required:
As the tax consultant to the company, you are to advise the management of the company on the tax implications for the relevant years of assessment.

Rates of capital allowances applicable:

	Initial Allowance	**Annual Allowance**
	%	**%**
Building	15	10
Plant and Machinery	50	25
Motor Vehicle	50	25

Ignore investment allowance.

(15 Marks)

SOLUTION TO QUESTION 4

Bassi & Co Tax Consultants
24, Ikorodu Road
P. O. Box 540
Marine
Lagos.
January 12, 2020

The Managing Director
Solid Rock Cement Limited
Ikorodu

Dear Sir,

RE: ADVICE ON TAX IMPLICATIONS OF PIONEER PERIOD AND POST PIONEER PERIOD

In response to your request on the above subject matter, we wish to advise you as follows:

(a) The pioneer period lasted for three years from 01/01/2015 (date of certification of the production day) to 31/12/2017 since there was no extension of the period;

(b) Profits made during the pioneer period from a pioneer enterprise (manufacturing of cement) are exempted from tax, while the profits made from the importation of cement (profits from non-pioneer enterprise) are taxable;

(c) The net loss incurred during the pioneer period and certified by FIRS is available for relief in computing the total profits of the new trade or business after the pioneer period;

(d) The qualifying capital expenditure incurred during the pioneer period as certified by the FIRS is deemed to have been incurred on the day following the end of the tax relief period, 1/1/2018 and capital allowances are granted with effect from that date;

(e) The company is deemed to have ceased its old trade or business on 31/12/2017 and to have commenced a new trade or business on 01/01/2018. The commencement provisions are therefore, applied in ascertaining the assessable profits for 2018, 2019 and 2020 years of assessment;

(f) The company is a manufacturing company, therefore there is no restriction on the amount of capital allowances claimable in a year of assessment provided there is sufficient assessable profit to absorb the capital allowances.

(g) Based on the information extracted from the company's records and applying the relevant provisions of the industrial development (Income Tax Relief) Act, Cap. 17 LFN 2004, the Companies Income Tax Act. Cap. C 21, LFN 2004 and the Tertiary Education Trust Fund (Establishment etc) Act, 2011, the company's tax liabilities are us presented below:

Year of assessment	Companies income tax (30% of total profits)	Tertiary education tax (2% of assessable profits)
	₦	₦
2015	270,000	18,000
2016	270,000	18,000
2017	240,000	16,000
2018	Nil	7,440
2019	Nil	7,440
2020	Nil	21,600

All the relevant computations are shown in the appendix. Please feel free to contact us should you require further clarification or assistance.

Yours faithfully,
For: Basis & Co. (Tax Consultants)
Amina Kama
Managing Partner

Appendix

Solid Rock Cement Limited – Computation of income tax liabilities non- pioneer trade of pioneer period

YOA	Basis period and workings	₦
2015	1/1/15 – 31/12/15	
	Assessable profits	900,000
	Income tax payable (30% x 900,000)	270,000
	Tertiary education tax payable (2% x 900,000)	18,000
2016	1/1/15 – 31/12/15	
	Assessable Profits	900,000
	Income tax payable (30% x 900,000)	270,000
	Tertiary education tax payable (2% x 900,000)	18,000
2017	1/1/16 – 31/12/16	
	Assessable profits	800,000
	Income tax payable (30% x 800,000)	240,000
	Tertiary education tax payable (2% x 800,000)	16,000

New Trade (Post Pioneer Period):

YOA	Basis period – workings	₦	₦
2018	1/1/18 – 31/12/18		
	Assessable profits (102,000+$^{3}/_{12}$ x 1,080,000)		372,000
	Less net loss of pioneer period b/f		300,000
	Remainder of assessable profits		
	Less capital allowances	1,206,000	

	Capital allowance relieved	72,000	72,000
	Unrelieved capital allowances b/f	1,134,000	
	Total profit		Nil
	Income tax payable		Nil
2019	1/1/18 – 31/12/18		
	Assessable profit (102,000 + $^{3}/_{12}$ x 1,080,000)		372,000
	Less capital allowance		
	-Unrelieved b/f	1,134,000	
	-for the year	291,000	
		1,425,000	
	-Relieved	372,000	372,000
	Unrelieved c/f	1,053,000	
	Total profit		Nil
	Income tax payable		Nil
	Education tax payable (2% x 372,000)		7,440
2020	1/1/18 – 30/9/19		
	Assessable profit		1,080,000
	Less capital allowances		
	-Unrelieved b/f	1,053,000	
	-for the year	291,000	
		1,344,000	
	-Relieved	1,080,000	1,080,000
	-Unrelieved c/f	264,000	
	Total profit		Nil
	Income tax payable		Nil
	Education tax payable (2% x 1,080,000)		21,600

Workings:
Solid Rock Cement Limited – computation of capital allowances

	Building	P &M	MV	Furniture	Total allowance
Total allowance	15%	50%	50%	25%	
Annual allowance	10%	25%	25%	20%	
	₦	₦	₦	₦	₦
2018 YOA (1/1/18 -31/2/18)					
Qualifying expenditure @1/1/18	850,000	700,000	750,000	250,000	
Initial allowance	(127,000)	(350,000)	(375,000)	(62,500)	915,000
Annual allowance	(72,250)	(87,500)	(93,750)	(37,500)	291,000
WDV c/f	650,250	262,500	281,250	150,000	
Total allowance					1,206,000
2019 YOA (1/1/18-31/12/18)					
Annual allowance	(72,250)	(87,500)	(93,750)	(37,500)	291,000
WDV c/f	578,000	175,000	187,500	112,500	
2020 YOA (1/1/18 -30/9/19)					
Annual allowance	(72,250)	(87,500)	(93,750)	(37,500)	291,000

EXAMINER'S REPORT

The question tests candidates' knowledge of pioneer status as it relates to its tax implications.

Few candidates attempted the question and performance was below average.

Commonest pitfalls include:

i. Inability to differentiate between pioneer and post-pioneer periods;
ii. Incorrect calculations of relevant assessable profits; and
iii. Wrong computation of capital allowances.

Candidates are advised to adequately cover all sections of the syllabus for better performance in future examinations.

5. (a) According to the Nigerian Minerals and Mining Act 2007, any person that undertakes or is involved in the search for or exploitation of mineral resources without the requisite mineral title or authority shall be guilty of an offence.

You are required to:
State any four licenses that are granted under the Nigerian Minerals and Mining Act 2007 to search for or exploit mineral resources in Nigeria and state any four conditions under which a mineral title may be revoked. (4 Marks)

(b) New Horizon Limited is engaged in the mining of solid minerals. The company commenced its mining business on July 1, 2017 and decided to prepare its accounts to June 30, annually. The profit or loss account of the company for the year ended June 30, 2018 recorded a net loss of ₦600,000 after taking into accounts the following:

	₦
Directors' remuneration	500,000
Mining expenses	8,500,000
Preliminary expenses written off	350,000
Administration expenses	1,700,000
Transportation expenses	1,600,000
Provision for income tax	165,000
Bad and doubtful debts	750,000
Office rent	1,220,000
Depreciation of non-current assets	110,000
Motor vehicle repairs and maintenance	400,000
Auditors' remuneration	105,000
Donations	250,000

The following additional information is available:

(i) Included in office rent is payment of ₦300,000 per annum for a flat used for residential accommodation by the Production Manager. The basic salary of the manager is ₦240,000 per annum.

(ii) An analysis of bad and doubtful debts account is as follows:

	₦
Specific provision for doubtful debts as at 30/6/18	160,000
General provision for doubtful debts as at 30/6/18	320,000
Trade debts written off during the period ended 30/6/18	170,000
Loan to customer written off during the period ended 30/6/18	100,000
	750,000

(iii) Donations comprise ₦50,000 to Ojota Social Club and ₦200,000 to University of Lagos.

(iv) Capital allowances agreed with the FIRS amounted to ₦275,000.

Required:
Compute the assessable profits and tax liabilities of the company for the relevant years of assessment. (11 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 5

(a) Licences granted under the Nigeria Minerals and Mining Act, 2007 are;
- (i) Reconnaissance permit;
- (ii) Exploration license;
- (iii) Small scale mining lease;
- (iv) Mining lease;
- (v) Quarry lease; and
- (vi) Water use permit.

Revocation of Mineral Title
A mineral title may be revoked if the holder:
- (i) Is convicted of an offence by a court of competent jurisdiction;
- (ii) Breaches any provisions of the Nigeria Minerals and Mining Act, 2007 or regulations made pursuant to the Act;
- (iii) Is declared insolvent or bankrupt by a court of competent jurisdiction;
- (iv) Before the expiration of the term of the license, surrenders the mineral title in the prescribed manner; and
- (v) In the case of a small mining lease, wholly discontinues operations under the lease for a continuous period of six months.

(b) New Horizon Limited
Computation of adjusted profit for the year ended
June 30, 2018

	₦	₦
Net loss per account		600,000
Less:		
Preliminary expenses written off	350,000	
Provision for income tax	165,000	
General provision for doubtful debts	320,000	
Loan to customer written off	100,000	
Office rent (300,000 -240,000)	60,000	
Depreciation of fixed assets	110,000	
Donation to Ojota social club	50,000	1,155,000
		555,000

New Horizon Limited
Computation of assessable profit and tax liabilities

	₦	₦
2017 YOA (1/7/17 – 31/12/17)		
Assessable profit ($^{6}/_{12}$ x 555,000)		277,500
Less:		
Capital allowances for the year	275,000	

Capital allowance relieved (reducted to $66^2/_3$ of 277,500)	(185,000)	(185,000)
Unrelieved capital allowance c/f	90,000	
Total profit		92,500
Income tax payable (30% x 92,500)		27,750
Tertiary education tax payable (2% x 277,500)		5,550
2018 YOA (1/7/17 – 30/06/18)		
Assessable profit		555,000
Less:		
Unrelieved capital allowances brought forward		90,000
Total profit		465,000
Income tax payable (30% x 465,000)		139,500
Tertiary education tax payable (2% x 555,000)		11,100
2019 YOA (1/7/17 – 30/6/18)		
Assessable total profit		555,000
Income tax payable (30% x 555,000)		166,500
Tertiary education tax payable (2% x 555,000)		11,100

EXAMINER'S REPORT

The question tests normal income tax computations as it relates to companies in the mineral resources sector, determination of assessable profits, commencement rule and tax liabilities.

Most of the candidates attempted the question but performance was below average.

Commonest pitfalls include:

i. Wrong calculations of the assessable profit;
ii. Wrong application of commencement rule for the first three years; and
iii. Failure to apply the capital allowance restriction rules of $66^2/_3$%.

Candidates are advised to make use of the Institute's study pack for better performance in future examinations.

6. Prosperity Bank Plc has been in banking business for several years. The interest on agricultural loans included in the accounts of the bank for the year ended December 31, 2017 amounted to ₦18,200,000.

The breakdown of the interest income based on the terms of the loan is as stated below:

Repayment Period	Moratorium Period	Interest Rate	Loan Interest ₦
7 years	36 months	14%	7,200,000
5 years	18 months	18%	5,600,000
4 years	24 months	12%	2,400,000
2 years	3 months	10%	3,000,000
			18,200,000

The base lending rate at the time the loans were granted was 15%.

Required:

(a) State the conditions under which the following interests may be exempted from tax:

(i) Interest on loans for agricultural trade or business; and (2 Marks)

(ii) Interest on loans for manufacturing goods for export. (2 Marks)

(b) Compute the interest exempted from tax in the case of Prosperity Bank Plc. (4 Marks)

(c) Highlight the special provisions of the Companies Income Tax Act, CAP C21, LFN 2004 regarding the taxation of an authorised unit trust scheme. (7 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 6

(a)(i) Interest on loan for agricultural trade or business interest on any loan granted by a bank on or after January 1, 1997 to a company engaged in agricultural trade or business shall be exempted from tax provided the moratorium is not less than eighteen months and the rate of interest on the loan is not more than the base lending rate at the time the loan was granted.
A bank is required to furnish the FIRS with the following information in respect of the loan granted:
(a) The amount of the loan;
(b) The moratorium;
(c) The date repayment is due to commence;
(d) The amount of repayment showing capital and interest; and
(e) The full particulars of the recipient of the loan and its permanent address.

(a)(ii) Interest on loan for manufacturing goods for export.
Interest payable on any loan granted by a bank on or after April 1, 1980 for the purpose of manufacturing goods for export is exempted from tax as stipulated in the third schedule to CITA. The exemption is granted on the presentation of a certificate issued by the Nigerian Export Promotion Council certifying that the company has achieved the level of export specified.

A company shall be deemed to be engaged in manufacturing for export if the Nigerian Export Promotion Council certifies that not less than one half of its manufactured good disposed of in its year of account is sold outside Nigeria and it is not re-exported to Nigeria.

(b) Prosperity Bank Plc
Computation of interest exempted from company income tax

Repayment period	Moratorium period	Interest rate	Amount of interest	Amount of interest exempted
		%	₦	₦
7 years	36 months	14	7,200,000	7,200,000
5 years	18 months	17	5,600,000	Nil
4 years	24 months	12	2,400,000	2,400,000
2 years	3 months	10	3,000,000	Nil
			18,200,000	9,600,000

Notes:
For an interest to be exempted from tax the moratorium period must not be less than 18 months and the lending rate must not exceed the base lending rate.

(c) Provisions of CITA on the taxation of authorised unit trust scheme
According to CITA, a unit trust scheme means any arrangement made for the purpose of providing facilities for the participation of the public as beneficiaries under trust in profits or income arising from the acquisition, holding, management or disposal of securities or any other property whatsoever.

A unit holder means any investor, beneficiary or person who acquired units in a unit trust schemes and who is entitled to a share of the investments subject to the trust of a unit trust scheme. A trustee under a unit trust scheme means the person in whom the property for the time being subject to any trust created in pursuance of the scheme is or may be invested in accordance with the terms of the trust.

In respect of the income arising to the trustees of an authorised unit trust, CITA shall have effect:

(i) As if the trustees were a company whose business consists mainly in the making of investments;

(ii) As if the rights of the unit holders were shares in the company; and

(iii) As if so much of the income accruing to the trustees as is available for payment to the unit holders were dividends on such shares.

The profits of an authorised unit trust scheme on which tax may be imposed shall be ascertained by taking the income accruing to the trustees from all sources of the investment of the unit trust and deducting there from sums disbursed as management expenses including the managers' remunerations where the trustees of a unit trust received an income which has suffered tax deduction at source (not being franked investment income), the withholding tax shall be set off against the tax assessment for the year so that the trustees will be required to pay only the balance of the tax due on assessment. Where the income accruing to the trustees is a dividend received after the deduction of withholding tax (franked investment income) it shall not be charged to further tax as part of the profits of the unit trust. However, where such income is redistributed and tax is to be accounted for on the gross amount of the distribution, the unit trust may set off the withholding tax which it has itself suffered on the same income.

The profit accruing to the trustees of a unit trust which is available for payment to the unit holders or for investment shall be deemed to be dividends paid or payable by the trustees to the unit to the unit holders in proportion to their rights and shall be subject to withholding tax in accordance with PITA.

Dividend distributed by unit trust is exempted from income tax with effect from 1996.

EXAMINER'S REPORT

The question tests candidates' understanding of the provisions of CITA, 2004 (as amended) regarding the exempted interests on loans granted to agricultural and manufacturing businesses and unit trust scheme.

Majority of the candidates attempted the question and of performance was below average.

The commonest pitfall of the candidates was inability to compute the exempted interest on loans.

Candidates are advised to pay attention to practical applications of taxation principles to real life situation for better performance in future examinations.

7. (a) The Nigeria content initiative was developed for oil and gas sector in order to provide a composite value added, through a deliberate utilisation of Nigeria human, material resources and services in the exploration, development, exploitation, transportation and sale of Nigerian crude oil and gas resources.

The initiative seeks to stimulate indigenous participation and encourage foreign investments without compromising quality and safety.

Consequently, the Federal Government of Nigeria enacted a law to provide for the development of Nigeria content in the oil and gas industry.

You are required to:

(i) Mention the title of the Act enacted to achieve the above objectives.

(ii) State Four (4) key objectives of the Act. (6 Marks)

(b) In relation to Petroleum Profit Tax Act, Cap P13, 2004 (as amended), briefly define the following:

(i) Petroleum Operation
(ii) Petroleum
(iii) Casing Head Petroleum Spirit
(iv) Oil Mining lease
(v) Gas Take (5 Marks)

(c) (i) Can an oil production company qualify for pioneer status? State reasons for your answer.

(ii) What taxes on income will it be exempted from during the pioneer period. Are there an income taxes on petroleum production that the company would not be exempted from? (4 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) (i) The title of the Act is "Nigerian Oil and Gas Industry content Development Act, 2010"

(ii) Four key objectives of the Act are:

(1) To provide equal opportunities to oil producing communities in the oil and gas value chain;
(2) To promote institutional collaborations;
(3) To ensure that the Nigeria providers are given first consideration in oil and gas participation;
(4) Create a business relationship with other sectors of the economy;
(5) To encourage full participation of Nigeria indigenous service provider who demonstrate ownership and capacity to execute such works; and
(6) Compliance with the Act shall be major criterion for approved operations in the Nigeria oil and gas industry.

(b) (i) Petroleum Operation

This is the mining or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations or process and all operations incidental thereto any sale or any disposal of chargeable oil by or on behalf of the company.

(ii) Petroleum

This is any minerals oil or related hydro-carbon and natural gas existing in its natural condition in Nigeria but does not include liquefied natural gas, coal, bituminous shale or other stratified deposits from which oil can be extracted by destructive distillation.

(iii) Casing Head Petroleum Spirit

This is any liquid hydrocarbons obtained in Nigeria from natural gas by separation or by any chemical or physical process but before the same has been refined or otherwise treated.

(iv) Oil Mining Lease
This is a lease granted to a company, under the minerals Act, for the purpose of winning petroleum or any assignment of such lease.

(v) Gas Take
This is the actual quantity of natural Gas expressed in much actually taken or paid for by a customer in the accounting period under an individual gas sales contract between the company and a customer of the company.

(c) (i) Yes, oil production and exploration companies are listed in the list of pioneer industries.
(ii) It is exempted from CITA.
It is not exempted from PPT

EXAMINER'S REPORT

The question tests candidate's knowledge of Petroleum profit tax terminologies, pioneer status of oil company and objectives of oil and gas industry content development Act of 2010.

Few candidates attempted the question and performance was below average.

Candidates' major pitfall is the lack of understanding of the Nigerian Oil and Gas Industry content Development Act of 2010 and pioneer provisions.

Candidates are advised to pay more attention to petroleum profit tax and related oil and gas acts for better performance in future examinations.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

PROFESSIONAL EXAMINATION

PTE II: FINANCIAL & TAX ANALYSIS

EXAM NO……………………….…………………….…..…. TIME: 3 HOURS.

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS

SHOW ALL WORKINGS.

1. Fabos Nigeria Limited, a company in the fashion industry has just filed its annual returns. Your controller has passed the returns to you for a desk examination, which includes analysis of the financial statements. Extract from the financial statements is shown below:

Fabos Nigeria Limited
Extract of financial statements

Income Statement	**2019**	**2018**
	₦'m	**₦'m**
Revenue	29.9	19.4
Cost of sales	(21.6)	(14.3)
Gross profit	8.3	5.1
Distribution costs	(1.3)	(0.5)
Administrative costs	(1.6)	(1.0)
Finance costs	(0.5)	(0.2)
Profit before tax	4.9	3.4
Income tax expense	(0.8)	(0.8)
Profit for the year	**4.1**	**2.6**
Statement of Financial Position		
Assets:		
Non-current assets:		
Property, plant and equipment	17.1	7.9
Current assets:		
Inventory	3.4	2.5
Trade receivables	3.6	2.8
Cash	--	0.1
	7.0	5.4
Total assets	**24.1**	**13.3**
Equity and Liabilities		
Equity:		
Ordinary share capital (₦1.00 each)	1.0	1.0
Retained earnings	9.9	5.8
Revaluation reserve	0.8	--
	11.7	6.8
Non-Current Liabilities		
Long term borrowings	3.8	2.3

Current Liabilities:		
Loans and borrowings	1.6	0.5
Trade payables	6.2	2.9
Income tax payables	0.8	0.8
	8.6	4.2
Total equity and liabilities	**24.1**	**13.3**

Required:

(a) Carry out an analysis of the financial statements that shows Fabos performance, efficiency and position. (20 Marks)

(b) Discuss possible risks and problem areas revealed by the financial statements analysis. (5 Marks)

(c) Discuss the limitation of financial statements analysis. (15 Marks)
(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) Analysis of the financial statements of Fabus Nigeria Limited, using ratios

i.	**PERFORMANCE**	**2019**	**2018**
	* Gross profit margin	8.3/29/9%	5.1/19.4%
		27.76%	26.29%
	* Net profit margin	4.9/29.9%	3.4/19.4%
		16.39%	17.53%
	* Return on capital employed	5.4/15.5%	3.6/9.1%
		34.84%	39.56%
	* Return on equity	4.1/11.7%	2.6/6.8%
		35.04%	38.23%
ii.	**EFFICIENCY**		
	• Net assets turnover	29.9/15.5%	19.4/6.8%
		1.93times	2.85times
	• Inventory turnover	21.6/3.4	14.3/2.5
		6.35times	5.72times
	• Receivable turnover	29.9/3.6	19.4/2.8
		8.31times	6.93times
	• Payable turnover	21.6/6.2	14.3/2.9
		3.48times	4.93times
	• Total sssets turnover	229.9/24.1	19.4/13.3
		1.24 times	1.46 times
iii.	**POSITION**		
	• Current ratio	7.0/8.6	5.4/4.2
		0.81:1.00	1.29:1.00
	• Quick ratio/ Acid test	3.6/8.6	2.9/4.2
		0.42:1.00	0.69:1.00
	• Leverage	3.8/15.5%	2.3/9.1%
		24.52%	25.27%
	• Interest cover	5.4/0.5	3.6/0.2
		10.8times	18times

(b) The ratios as calculated for the two years are looking good and generally show an improved performance. However, the following areas should be probed further to ensure that the tax payer is not engaged in unwholesome tax avoidance:

(i) Net profit margin dropped despite an increase in gross profit margin. This means that expenditures on administration and distribution have gone up significantly. These should be probed further to ensure that the company is not overstating these expenses.

(ii) Inventory turnover has reduced from 11.8 times to 6.4times. It shows that the company maintaining more inventory in 2019 than in 2018. There is a need to probe further that the company is not overstating its inventories or maintaining a secret reserves;

(iii) Finance cost went up from ₦0.2m to ₦0.5m in 2019. The rate of increase of 250% is far more than the rate of increase in total borrowings of 193%. Details of finance cost should be requested for confirmation that the charges are in accordance with the terms of the loans;

(iv) Current ratio has dropped from 1:29 to 0.81, which shows that the company is having liquidity problem, and may not be able to meet all its current obligations. This already shows in the drop in the payable turnover from 4.9times to 3.5times. This means that it now takes 103days to pay the suppliers instead of 74days in 2018. The ability of the company to pay the tax due should be probed further.

(c) There are several limitations or weaknesses in the techniques being used in the analysis and interpretation of financial statements. Some of these limitations are based on the limitation of the financial statements from which ratios are calculated.

Therefore, financial analysts should know that the result of financial statements analysis are as good as the reliability of the components of the financial statements being analysed. The reliability of the financial statements can be affected by the following:

(i) Differences in accounting policy: When analysing and comparing ratios from different companies, the analyst must ensure that the companies adopt the same accounting policy, otherwise, the comparison will be meaningless. Therefore, where the companies do not adopt the same accounting policy, there will be need to do some adjustments so as to make the financial statements of the companies comparable

Also, different companies in the same industry has different characteristics which in turn affect the components of the financial statements, therefore, the analyst should consider the characteristics of the various companies being compared before concluding his interpretation.

In the same way, when comparing the ratios of a company with the industry average, the analyst must ensure that he takes into consideration the nature, size and the position of the company in the industry.

Another important thing the analyst should note when comparing different companies' ratios is that although the companies might have adopted the same accounting policy, their application of the policy might be different;

(ii) Limitations of historical cost accounting: Historical cost accounting did not take into account the time value of money, financial statements prepared using historical costs can be misleading as a result of inflation when the rate of inflation is high, non-current assets will probably be undervalued in the financial statements, when compared with the current replacement value. In the same way, the profit reported under historical cost accounting will be higher than it would be when any of the inflation adjusted

accounting systems such as, current cost accounting and current purchasing power accounting are used.

(iii) Creative accounting and management bias: Due to intentional bias of management, the financial statements can be manipulated by management, while still complying with the relevant accounting standards through creative accounting. Some of the methods commonly used are:
* Window dressing;
* Off statement of financial position finance;
* Changes in accounting policies or accounting estimates;
* Profit smoothing;
* Aggressive earnings management;
* Capitalising expenses; and
* Big bath accounting.

(iv) Related party relationship and transactions: Related party transaction can also affect the reliability of the financial statements if such transactions are not at arm's length; and

(v) Useful non-financial information: These are non-financial information that are useful in the interpretation of accounting ratios and the analyst must take them into consideration, these include:
* The company's objectives and strategies;
* The main risks and uncertainties the company is facing and how these risks are being managed;
* Any significant factors or events that could impact on the company's performance in future;
* Any significant factors or events that could impact on the company's cash flows in future;
* Information about key relationships with other companies and transactions with related parties including management; and
* A description of the company's research and development activities (if any) and of any material intangible assets, including internally generated intangible assets that have not been recognised in the statement of financial position.

EXAMINER'S REPORT

The question, which is in three parts (a, b & c) tests candidates knowledge of financial ratios analysis and limitations of ratio analysis. It is a compulsory question of 40 marks and performance was very poor. This question is a familiar terrain in financial analysis but it is disappointing that majority of the candidates could not compute simple profitability, efficiency and liquidity ratios. Majority of the candidates could not even state the limitations of ratio analysis which is a common topic in financial analysis.

The requirements of the question was straight forward but about 40% of the candidates computed trend analysis while those who even understand the ratios to be computed could not compute them correctly.

Candidates are advised to study adequately for future examinations by reading the Institute study pack and other relevant textbooks.

2. One of the reasons why a financial analyst needs to carry out accounting analysis is the issue of distortions that may be in the financial statements.

Required:
Discuss assets distortions and the causes of assets distortions. (15 Marks)

SOLUTION TO QUESTION 2

Assets distortion refers to a situation where the assets value of an entity did not reflect its economic reality.

Assets distortions can arise due to the following situations:

(i) Provisions: There are various provisions that are required to be made in connection with the various assets in the financial statements, for example:
- Provision for depreciation on property, plant and equipment (PPE)
- Provision for inventories, due to loss of value as a result of obsolescence, slow moving items, etc;
- Provision for expenses and revenue not yet earned; and
- Bad debt allowance on receivables.

Recognition of too much or too little provisions on the above can distort the total assets value of the company reported in the financial statement. At the same time, management has the discretion to determine what obligation is probable and what the estimate should be. It may also be possible that what management states as contingency liabilities in the notes to the financial statements has actually crystalise;

(ii) Asset impairment: Recognising too much or too little impairment of PPE, investment and intangibles can cause distortions in the assets value. This is because estimation of fair value is subjective and can be a veritable ground for management bias, management can therefore, delay reporting impairment in the financial statement;

(iii) Timing of revenue recognition: The management can manage the earnings reported in the financial statements through aggressive revenue recognition. This will affect the figures stated for both revenue and trade receivables in the financial statements;

(iv) Expenses capitalisation: As a form of earnings management, expenses could be capitalised or deferred too much or too little. Management, under IAS 23, has discretion in deciding whether to capitalise or expense interest and expenditure required to get PPE and inventory to current location and condition. Deferred expenditure is capitalised into the cost of the asset and this will impact on income. However, if the management decides that the potential future benefits cannot be reliably measured, the standard allowed management to expense the expenditure;

(v) Leased assets: If the entity uses substantial leased assets and these are not brought into the financial statements, it will lead to reduction in the value of the entity's assets which will result in distortion. However, with the introduction of IFRS16, the dichotomy between finance and operating lease has been removed. All leased assets must now be capitalised as right of use assets and reported on the statement of financial position with its counterpart lease liability.

EXAMINER'S REPORT

The question tests candidates' knowledge of assets distortions and their causes. Performance was below average. Only very few candidates have good understanding of assets distortion. Since many of the candidates did not understand what asset distortions is, they could not identify their causes. The few candidates that understood assets distortions were not able to give the causes of assets distortion.

Candidates are advised to have good coverage of the syllabus to enhance good performance in future examinations.

3. Dotec Nigeria Limited purchased a non-current asset for ₦20million in January 2016. The non-current asset is being depreciated on a straight line basis over four years, resulting in annual depreciation of ₦5million. Assume a tax rate of 30%.

The capital allowances granted the company by the tax authority are:

	₦'million
2016	12.5
2017	2.5
2018	2.5
2019	2.5

Required:

(a) Prepare a table to show the carrying value of the assets and the tax written down value of the asset in the books of Dotec Nigeria Limited for each of the years. (8 Marks)

(b) Prepare a table to show the company's deferred tax liability for each of the four years.

Your table should show the following:

(i) Opening deferred tax liability.

(ii) Increase/(decrease) in the year.

(iii) Closing deferred tax liability. (7 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) Carrying value and tax written down value

Year	Carrying value	Tax written down value	Difference
	₦'m	₦'m	₦'m
2016	15	7.5	7.5
2017	10	5	5
2018	5	2.5	2.5
2019	Nil	Nil	Nil

(b)

Year	2016	2017	2018	2019
	₦'m	₦'m	₦'m	₦'m
Opening deferred tax liability	0	2.25	1.5	0.75
Increase/decrease in the year	2.25	0.75	0.75	0.75
Closing deferred tax liability	2.25	1.5	0.75	0

EXAMINER'S REPORT

The question tests candidates' knowledge of deferred taxation. The question is straight forward and involved simple calculation of deferred tax liability. About 50% of the candidates attempted the question. However, performance was below average but there were exceptional candidates that performed well in the question.

The common pitfall was that most candidates that attempted the question did not have good knowledge of how to compute deferred tax liability.

Candidates are advised to cover every aspect of the syllabus when preparing for the Institute's examination in the future by reading the related study pack on each course.

4. Mergers and acquisitions are part of the strategies to grow businesses all over the world. However, mergers and acquisitions give rise to tax issues that need to be sorted out.

Required:
Discuss tax issues that should be taken into consideration in mergers and acquisitions.
(15 Marks)

SOLUTION TO QUESTION 4
Tax issues that should be taken into consideration in merger and acquisition are.

(a) A merger may result in any of the following situations:
- Formation of a new company;
- Continuation of the consolidated business by one of the merging parties in its name or under a new name;
- Cessation of business by the other merging parties; and
- In acquisition, there is only an acquiring company and the company being acquired.

Emergence of a new company and rendition of annual returns. Where a new company emerges from a merger process, then the new company is expected to file its returns, in line with the provision of section SS(3)(b) of CITA for new company.
However, if it is a mere change of name, such company or companies will continue to be treated as old business.

(b) Claim of allowances: Companies Income Tax Act (CITA) does not categorically address the value at which assets may be transferred for the purpose of capital allowances claim. However, IFRS 3prescribes that in merger accounting, the assets, liabilities and resources must be recorded at their carrying balances, implying that merger process does not permit the recording of assets at their fair value in the event of consolidation. The new company will therefore not be entitled to any investment allowance on the tax written down values of the transferred assets.

(c) Unabsorbed losses and un-utilised capital allowance brought forward. The new company may also not be permitted to inherit the unabsorbed losses and capital allowances of the absorbed companies, except under the following circumstances.
- Where a reconstituted company is carrying on the same business previously carried on by this company and it is proved that the losses have not been allowed against any assessable profit or income of that company for any such year, in that case the amount of unabsorbed losses shall be demand to be a loss incurred by the re-constituted company in its trade or business during the year of assessment in which the business commenced.

(d) Taxes and deductibility of related expenses. These are necessary as follows:
(i) Stamp duties payment that will arise on the share capital of the new company subject to the provisions of section 104 of the Stamp Duties Act in relation to capital and duty relief.
(ii) Consolidated expenses: Fees paid to statutory bodies like SEC, NSE, CBN, land authorities etc, including professionals like accountants, stockbrokers, issuing house and solicitors are regarded as capital in nature and will therefore, not be allowed as deductible expenses by virtue of section 27(a) of CITA.
(iii) Taxation of consolidation fees: Fees paid to professionals for services rendered in connection with consolidation will be subject to VAT and WHT at the rate of 5% and 10% respectively.

(e) Tax indemnifications: section 29(i) of CITA provides that the Service may require the new company to guarantee or give security for payment in full, for any tax due or that may become due by any of the ceased companies.

(f) Approval of Pension Scheme: The new company will need to obtain a Joint Tax Board (JTB) approval for its staff pension scheme.

EXAMINER'S REPORT

The question tests candidate's knowledge of issues that can arise in mergers and acquisition of companies. It is a straight forward question and majority of the candidates attempted the question. Performance of the candidates is just average despite the fact that the question is straight forward. Most candidates have good understanding of the requirements of the question but do not have indepth knowledge of tax issues that can arise on mergers and acquisitions.

Candidates need to be more prepared for their examination as the Institute has made available online study packs to enhance better performance in the Institute's examination.

5. Corporate strategies recognised two broad categories of entity's environment. These are the internal and external environments.

   Required:

   Explain the different aspects of internal and external environment emphasising the nature of their impact on the capability of an organisation and ultimately on its strategic advantage.
   (15 Marks)

SOLUTION TO QUESTION 5

The environment of an organisation is very crucial to its success and relevant strategies must be formulated in line with the factors operating in the environment of an organisation.

Organisation has both internal and external environments

The internal environment refers to all factors within an organisation that impact strength or cause weaknesses of strategic nature. The external environment includes all the factors outside the organisation which provide opportunities or pose threat to the organisation.

The environment in which an organisation exists can therefore, be described in term of those strengths and weaknesses existing in the internal environment and the opportunities and threats existing in the external environment.

The four environmental influences that can impact on the capability of an organisation and its strategic advantage are as follows:

Internal environment: Strength is an inherent capacity which an organisation can use to gain strategic advantage. Examples of strengths are good reputation among customers, resources, assets, people, experience, knowledge, data and capabilities.

Weaknesses is an inherent limitation or constraints which creates strategic disadvantages, example of weaknesses are gaps in capabilities, financial deadlines, low employee morale and overdependence on a single product line.

External environment: Opportunity is a favorable condition in the organisation's external environment which enables it to consolidate and strengthen its position. Examples of opportunities

are economic boom, favourable demographic shifts, arrival of new technology, favourable global influences and unfulfilled consumer needs.

Threat is an unfavourable condition in the organisational external environment which creates risk for or causes damage to, the organisation. Examples of threat are economic downturn, demographic shifts, new competitors, unexpected shift in consumer taste, new regulations, unfavorable political or legislation and new technology.

An understanding of the external environment in terms of the opportunities and threats and the internal environment in term of the strengths and weaknesses are crucial for the existence growth and profitability of any organisation, as well as, crafting of appropriate strategies to take advantage of opportunities and strengths and to minimise the impact of threats and weaknesses.

EXAMINER'S REPORT
The question tests candidates' knowledge of the environment of business classifying it into internal and external environment. Candidates are expected to emphasise the impact of the environment on the capability of an organisation. Performance was below average. The candidates did not understand the requirements of the question as many of them were writing on PESTEL or Porters model rather than using SWOT that the question required. Few candidates that understood the question could not discuss how SWOT can impact on the capabilities of an organisation.

Candidates are advised to read the study pack on this subject very well to enhance performance in the Institute examination in the future.

6. (a) What is accounting analysis? (5 Marks)

   (b) Explain those things that must be taken into consideration when performing accounting analysis. (10 Marks)
   (Total 15 Marks)

SOLUTION TO QUESTION 6

(a) Accounting analysis is the analysis that assesses the degree to which an entity's accounting reflects the underlying business reality. This is done by rectifying any accounting distortions and evaluating their impact on profit and the substantiality of profits. Having identified any accounting distortions, analyst can then adjust the entity's accounting numbers using cash flow and foot notes information to undo the distortions.

The basic issue in carrying out accounting analysis is the consideration whether the accounting numbers match the business reality/nature of the firm.

Prelude to a quality accounting analysis, the analyst need to understand:
- The business;
- What the business is doing;
- The accounting policy;
- The business areas where accounting quality is most needed; and
- Situation in which management are particularly tempted to manipulate accounting figures.

(b) To perform accounting analysis, the following points must be considered:
   (i) Identify key principal accounting policies: Accounting policies have effect on figures presented in the financial statements. The way each organisation treats issues like material, depreciation, capitalisation of some expenses contributes to variation in profit to be reported in the financial statements. In carrying out accounting analysis,

some of these issues must be looked into, to ensure that the accounting policies are still within the normally acceptable policies for financial reporting;

(ii) Identify and evaluate the policies and estimates the entity uses to measure critical business factors and key risks. Such evaluation will inform the analyst on how these policies affect the organisation's financial statements;

(iii) Financial reporting allows the organization to be flexible in the preparation of their financial statements as long as it is within the normal accounting practices. In performing accounting analysis, this flexibility must be assessed;

(iv) It is necessary to evaluate accounting strategy because if managers have accounting flexibility, they can use it either to communicate their firm's economic situation or to hide true performance;

(vi) It is necessary to evaluate how the firm's accounting policies compare to that of the industry in which the firm operates. In some industry, they practice uniform costing and accounting system. The analyst need to know how much the firm has conformed to the industry practice;

(vii) The quality of disclosure must be evaluated as well as determining the adequacy of such disclosure; and

(viii) Identification of potential red flags (accounting distortions) should be carried out and any of these distortions should be corrected when performing accounting analysis.

EXAMINER'S REPORT

The question tests the candidates' knowledge of accounting analysis. The part (a) of the question require candidates to define accounting analysis while the part (b) requires the candidate's to explain those things that must be taken into consideration in performing accounting analysis. Majority of the candidates attempted the question but performance was below average. The major pitfall is that the candidates confused accounting analysis with financial analysis, therefore, the question was poorly answered.

Candidates did not read the study pack on this subject very well because accounting analysis is specifically distinguished from financial analysis in the study pack.

Candidates are advised to read the study pack on the subject very well to enhance better performance in future examinations of the Institute.

7. One of the major policy thrust of the Nigerian government is to attract Foreign Direct Investments (FDI) into the country. To do this, the government introduced some tax incentives into the Nigeria tax regime.

Required:

Discuss Six (6) of such tax incentives that is aimed at attracting FDI into the country.

(15 Marks)

SOLUTION TO QUESTION 7

The government at all levels in Nigeria have been conscious of making policies that will attract foreign direct investments into the country, to boost the country's economic development.

Some tax incentives introduced by the government into the country's tax regime to attract foreign investors are:

(a) Tax holidays: The government introduced the concept of pioneer companies into the tax system whereby companies going into the production of products that are judged to be pioneer products are granted tax holidays of between three to five years;

(b) Accelerated capital allowance: Capital allowance, as an allowable expenses can be accelerated by increasing the rate of annual capital allowance. This will allow for earlier write off of assets being used for business;

(c) Joint Venture: This is an arrangement whereby government enters into joint venture agreement with foreign companies, especially in the oil industry, to reduce financial risks and therefore, make the project attractive to foreign investors;

(d) Production sharing contract: This is a situation where government arranges for the crude oil producing companies to recover cost, pay taxes and share profit with crude oil;

(e) Investment allowance: This is granted in proportion of qualifying asset in addition to initial and annual allowance in the year the qualifying asset is first put into use. It is not deductible before arriving at the tax written down value (TWDV) of the asset. However, it is limited to some sectors of the economy;

(f) Free Trade Zone (FTZ): FTZs were established so that companies that operate within the zone can enjoy a lot of benefits/tax incentives, protection etc., free import duty on materials etc.

(g) Exemption from minimum tax provision: A company with at least 25% imported equity is exempted from the provisions of minimum tax in the first four years of operation;

(h) Export Development Fund (EDF): This is an incentive in the agricultural sector. It is a special fund set up by the government to provide special assistance to private sector exporting companies to set off part of their initial expenses provided such company meet the conditions set up by the Nigeria Export Promotion Council; and

(i) Ownership of mining: One hundred percent ownership of mining operations and other related enterprises have been allowed by the government.

EXAMINER'S REPORT

The question tests candidate's knowledge of tax incentives that encourage Foreign Direct Investment (FDI) into Nigeria. The question is a straight forward question but many of the candidates could not identified tax incentives available for foreign direct investment, therefore, performance was below average. The commonest pitfall is that majority of the candidates mistake tax incentive for encouraging direct foreign investment for capital allowance.

Candidates are advised to read questions very well and understand the requirements of questions before they start to answer the questions. They should also read the study pack provided by the Institute when preparing for future examinations.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

PROFESSIONAL EXAMINATION

PTE II: INTERNATIONAL TAXATION

EXAM NO……………………….…………………………..…. **TIME: 3 HOURS.**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS

SHOW ALL WORKINGS.

1. Yeye Owa Consultancy Service, a firm of Chartered Tax Practitioners, was registered in 2016. In 2018, it expanded to Ghana to tap into the booming business opportunities in that country.

   The directors have heard of double taxation agreement with the relevant benefits, though the company has never been a beneficiary.

   Below is the summary of the income statement for the year ended December 31, 2018:

	Nigeria	**Ghana**	**Total**
	₦	**₦**	**₦**
Gross professional fee	58,000,000	23,000,000	81,000,000
Other income	1,200,000	800,000	2,000,000
	59,200,000	23,800,000	83,000,000
Deduct expenses:			
Deal execution	(30,000,000)	(11,000,000)	(41,000,000)
Office rent	(1,900,000)	(720,000)	(2,620,000)
Depreciation	(7,200,000)	(2,900,000)	(10,100,000)
Loss on sale of assets	--	(620,000)	(620,000)
Foreign exchange loss provision	(1,100,000)	--	(1,100,000)
Other operating expenses	(4,300,000)	(1,900,000)	(6,200,000)
Net operating profit	14,700,000	6,660,000	21,360,000

Additional information:

(i) The sum of ₦2,400,000 was paid to the Ghana Tax Authority for the year after claiming ₦5,100,000 capital allowance. Capital allowance claimable in Nigeria was ₦8,800,000.

(ii) Other income of ₦1,200,000 is profit from sale of non-current assets, while ₦800,000 is gains from disposal of securities.

Required:

As a professional tax practitioner

(a) Explain briefly what is meant by double taxation relief. (4 Marks)

(b) Compute the double tax credit claimable by the company considering there is no double taxation agreement with Ghana. (30 Marks)

(c) Compute the company income tax payable after the credit. (6 Marks)
(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) Double taxation relief (DTR) is a credit available in Nigerian tax laws on income that has suffered foreign tax outside Nigeria and now brought into Nigeria. The objective is to ensure that income liable to Nigeria tax brought into Nigeria from other countries does not suffer tax twice.

The process of determining the extent of the credit depends on whether or not the foreign country has a double taxation agreement with Nigeria.

(b)

YEYE OWA CONSULTANCY SERVICE
COMPUTATION OF DOUBLE TAX RELIEF
FOR 2019 TAX YEAR

Details	**Nigeria**	**Ghana**	**Total**
	₦	₦	₦
Net profit b/f	14,700,000	6,660,000	21,360,000
Add /(Deduct)			
Other Income	(1,200,000)	(800,000)	(2,000,000)
Depreciation	7,200,000	2,900,000	10,100,000
Loss on sale of asset	Nil	620,000	620,000
Exchange loss prov.	1,100,000	Nil	1,100,000
Adjusted profit	21,800,000	9,380,000	31,180,000
Deduct:			
Capital allowance	(8,800,000)	(5,100,000)	(13,900,000)
Total profit	13,000,000	4,280,000	17,280,000

Relief rate; lower of CWRT and NRT

CWRT $\frac{\text{foreign tax paid}}{\text{Foreign total profit}}$ $\frac{₦\,2,400,000}{₦\,4,280,000}$ x 100% = 56%

½ NRT = $\frac{30}{2}$ = 15%

Therefore, relief rate to be adopted is 15% companies income tax payable

(c) Companies income tax payable after DTR

Total profit	N17,280,000
	₦
Companies income tax payable @ 30%	5,184,000
Less DTR @ 15% of Ghana total profit	642,000
Companies income tax payable after DTR	4,542,000

Tertiary Education tax @ 2% of assessable profit = $^{2}/_{100}$ x N31,180,000 = N623,600

EXAMINER'S REPORT

The question tests candidates' knowledge of double taxation arrangements with emphases on double taxation relief and the computation of companies income tax payable after the tax credit claimable.

Most of the candidates attempted the question and performance was below average. Candidates displayed poor knowledge of the explanation of double taxation relief and found it difficult to compute companies income tax payable after the credit.

Candidates are advised to ensure that they understand the requirements of the question before attempting it to perform better in future examinations.

2. (a) Ringworm is an American Company incorporated in Panorama and based in Houston Texas. It hired out two rigs 'Faith' and 'Favour' for drilling off-shore Nigerian territorial waters. It appointed The Young Services (Nig.) Limited as its Nigerian dependent agent. It was assessed on its receipts from the rig business but appealed against the assessment claiming non-residence status.

Required:

(i) State whether or not Ringworm has a permanent establishment in Nigeria. (2 Marks)

(ii) Give reasons for your answer in "a" above. (5 Marks)

(b) Explain the following terms with examples

(i) Comparable Uncontrolled Price (CUP). (4 Marks)

(ii) Advance Pricing Agreements (APA) (4 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) (i) Yes, Ringworm has a permanent establishment in Nigeria

(ii) The reasons for the answer are:

- The fact that rigs 'Faith' and 'Favour' are operating on Nigeria waters creates a presence for Ringworm in Nigeria, hence, the non-resident company is taxable on income derived from the rig services.

- The appointment of Young Services (Nig) Ltd as a dependent agent constitutes a permanent establishment for Ringworm in Nigeria going by the provisions of Articles of the agreement for the avoidance of double taxation. However, there is no such agreement between Nigeria and the United States of America. Therefore, Young Services will constitute a fixed base under Section 13 of Companies Income Tax Act.

- The assessment issued by the tax authorities will stand as long as it is based on the income/profit attributable to the operations of the rigs in Nigeria

(b) (i) Comparable Uncontrolled Price (CUP) is a transfer pricing method used to compare the price charged for transactions between associated enterprises (related parties) with the prices charged for similar transactions between independent enterprises (unrelated parties) in comparable circumstances. For example, Altas Inc. UK provides logistic services to its subsidiary, JK Nig Ltd, at a value of $1.5m per year. The same services were also provided to BNJ Nig Ltd at a value of $1.2million for the same quality in the open market.

The price charged to BNJ will be the CUP for determining the arms length price between Altas Inc. Uk and JK Nig Ltd.

(ii) Advance Pricing Agreement (APA): Advance Pricing Agreement allows for advance solution of complex transfer pricing issues that may arise in the application of the arms length principle, in accordance with the provisions of The Income Tax (Transfer Pricing) Regulations, 2018.

Put differently, APA is an arrangement that determines in advance of controlled transaction, an appropriate set of criteria (e.g method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time.

An advance pricing arrangement may be unilateral involving one tax administration and a taxpayer or multilateral involving the agreement of two or more tax administrations.

For example, Kellog Industries intend to install new production line in 2017 and most of the parts are to be bought from a related company KIG Inc, UK for a value of $250million. Kellog Industries Ltd is expected to agree the pricing with the FIRS ahead of entering into the transaction.

EXAMINER'S REPORT

The question tests candidates' knowledge of the rules of permanent establishment and transfer pricing regulations.

Few of the candidates attempted the question and performance was below average. Candidates displayed poor knowledge of the basic principles of transfer pricing and the concept of permanent establishment in the determination of tax liabilities of non-resident companies.

Candidates are advised to read widely before sitting for an examination for better performance in future.

3. (a) (i) What is passive income? (3 Marks)

(ii) State and explain some taxing rights commonly expressed in the tax treaties for the purpose of avoiding double taxation to passive incomes. (7 Marks)

(b) Nigeria has signed and concluded agreements for the avoidance of double taxation with some other countries. List ten (10) of such countries with tax treaties in force. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a)(i) Passive income is an income received on regular basis with little effort required to maintain it. It is closely related to the concept of "unearned income." It includes income derived from investment in a rental property and shares of a company. Passive income includes royalty, dividend and interest.

(ii) The factors to consider in determining taxing of passive income are:

- The exclusive right of either the residence state or source state to tax the income
- The primary right of the source state to tax the income. This implies that the residence state will only tax the amount not taxed in the source state.
- Joint right of the residence and source states whereby both may tax the income.

In all the above cases, taxes already paid at the source state would be considered under elimination of double taxation as provided in Elimination of Double Taxation Article in the tax treaty with a view to avoiding double taxation of the passive income.

In some instances, withholding tax deducted at source on such income is considered as final tax in the source state.

(b) Ten (10) countries having tax treaties with Nigeria in force are:
(i) United Kingdom and Republic of Ireland
(ii) Romania
(iii) Italy (Transportation only)
(iv) Netherlands
(v) Belgium
(vi) Philipines
(vii) Canada
(viii) France
(ix) Pakistan
(x) South Africa
(xi) China

EXAMINER'S REPORT

The question tests candidates' knowledge of types of passive income, taxing rights of contracting states in respect of passive income and the countries with which Nigeria has double taxation agreements.

Most of the candidates attempted the question and performance was average. The commonest pitfall of the candidates was their inability to explain some taxing rights commonly expressed in tax treaties for the purpose of avoiding double taxation of passive incomes.

Candidates are advised that they should ensure covering of all the topics in the syllabus before sitting for future examinations.

4. (a) The Companies Income Tax Act (CITA) does not define what constitutes a fixed base, but Section 13(3) of the Act states what are excluded. State these exclusions. (5 Marks)

(b) What are the conditions precedent to obtaining tax treaty benefits? (4 Marks)

(c) Article 7 of the Nigerian model of the avoidance of double taxation treaty is on business profits. List Three (3) of the basic rules of the Article. (6 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

According to the provisions of section 13 (3) of the Companies Income Tax Act, items excluded from what constitutes a fixed base are:

(a) (i) Facilities used solely for the storage or display of goods or merchandise; and
(ii) Facilities used solely for the collection of information.

(b) The conditions precedent to obtaining the tax treaty benefits are:
(i) The taxpayer must be a resident;
(ii) The taxpayer must be covered by the treaty;
(iii) The taxpayer must be subject to tax on the income; and
(iv) The benefits must not be specifically excluded by the provisions of the treaty.

(c) The basic rules of Article 7 on business profits are:
(i) The rights of the country of residence to tax the profits from cross border business activities limited to part of the profit taxed in the source state;
(ii) Where there is a permanent establishment (PE), the country of source has unlimited right to tax the profits attributable to the permanent establishment (PE);
(iii) The country of source has the right to tax and the country of residence has the duty to eliminate double taxation by granting relief for tax paid at source; and
(iv) The basis of allocation of profits between the enterprise and the permanent establishment must reflect arm's length principle.

EXAMINER'S REPORT

The question tests candidates' knowledge of what constitutes a fixed base and the exclusions, and tax treaties.

Few candidates attempted the question and performance was below average. The commonest pitfalls of the candidates were their inability to state the conditions precedent to obtaining tax treaty benefits and the basic rules of Article 7 on business profits.

Candidates are advised to ensure they are conversant with the treatment of business profits arising from cross border transactions and the conditions precedent before a taxpayer can benefit from tax treaties.

5. (a) Describe the following terms:
(i) Tax Avoidance (2 Marks)

(ii) Tax Evasion (2 Marks)

(b) Identify Four (4) possible effects of tax evasion on the economic development of Nigeria. (6 Marks)

(c) Briefly describe one decided case on tax evasion and avoidance in Nigeria. (5 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 5

(a)(i) Tax avoidance is the process whereby an individual plans his/her finances so as to apply all exemptions and deductions provided by tax laws to reduce taxable income.

(ii) Tax Evasion increase is an unlawful attempt to minimise tax liability through fraudulent techniques to circumvent or frustrate tax laws, such as deliberate under statement of taxable income or willful non-payment of due taxes.
Whereas tax evasion is an offence (punishable by both civil and criminal penalties), tax avoidance is not.

(b) The effects of tax evasion on the economic development of Nigeria include:
(i) Tax evasion generates investment distortion in the form of the purchase of assets under-valued for tax purposes;
(ii) These practices erode moral values and build up inflationary pressures. This point can be buttressed with the fact that because of the evasion of tax, individuals and companies have a lot of money at their disposal. Companies declare higher dividends and have a high take home profit;
(iii) This increase the quantity of money in circulation but without a corresponding increase in the goods and services;
(iv) Inflationary trends will erupt, as large quantities of money will chase few goods; and
(v) It creates a negative effect on government revenue.

(c) Global Marine Baltic Incorporation (GMBI) vs Federal Inland Revenue Service (2013) 12 TLRN.
The case was between GMBI, a drilling company registered and incorporated in accordance with the laws of the State of Delaware (USA), which entered into an agreement to provide drilling services in Nigeria to Global Offshore Drilling Limited (GODL), a Nigerian company and the FIRS.

The major issue for determination was whether recharges by a subcontractor should be included as part of the turnover of non-resident companies for the purpose of assessment to tax on deemed profit basis.

GMBI argued that the inclusion of turnover of non-resident companies for the purpose of assessment to tax on deemed profit basis would lead to double taxation.

The position of the FIRS was that GMBI was wrong to have made a deduction for the recharges under the deemed profit basis and that such deduction for expenses are only allowed under the actual profit basis.

Ruling: The Tax Appeal Tubunal (TAT) ruled out GMBI's assertion that the FIRS' treatment would amount to double taxation, stating that double taxation can only happen where the same income is taxed more than once in the hands of a single taxpayer.

EXAMINER'S REPORT

The question tests candidates' knowledge of the distinction between tax avoidance and tax evasion. The candidates are also expected to state the possible consequences of tax evasion on the socio-economic development of Nigeria.

Most of the candidates attempted the question and performance was below average. The commonest pitfalls of the candidates were their inability to state the effects of tax evasion on the economic development of Nigeria and a decided case on tax evasion and avoidance.

Candidates are advised to read widely before sitting for future examinations.

6. (a) Explain the term Mutual Agreement Procedure (MAP) in relation to cross border tax issues. (5 Marks)

(b) Discuss five (5) criteria required for Mutual Agreement Procedure application. (10 Marks)

(Total 15 Marks)

SOULTION TO QUESTION 6

(a) Mutual Agreement Procedure (MAP): Mutual Agreement procedure is applicable for resolving tax disputes arising from cross border transactions and interpretation or application of tax treaties.

It is an administrative procedure provided for in tax treaties for resolving difficulties arising out of the application of the tax treaties.

The procedure is commonly used in cases of double taxation that are not clearly resolved by the treaty (e.g. allocation of head office expenses, arm's length allocation of profits between associated enterprises).

(b) Five criteria for applying mutual agreement procedure are:

(i) Negotiation based on MAP application is between the competent authorities of the treaty countries;
(ii) It is applicable only when there is a tax treaty between the two countries;
(iii) It is also applicable where it is perceived that the actions of one or both treaty states would violate treaty terms;
(iv) Irrespective of the position of the domestic law, agreement reached must be implemented; and
(v) The issues involved must be presented by the affected taxpayer within the time frame allowed by the tax treaty provisions to the competent authority of the country of residence.

EXAMINER'S REPORT

The question tests candidates' knowledge of one of the means through which contracting states consult to resolve cross-border tax disputes, that is, Mutual Agreement Procedure.

Few of the candidates attempted the question and performance was poor. Most of the candidates misconstrued Mutual Agreement Procedure as Double Taxation Relief, whilst some could not state the criteria that must be met before applying Mutual Agreement Procedure.

Candidates should ensure that they cover all the topics in the syllabus before sitting for future examinations.

7. Write short notes on the following;

(a) 'Arm's length principle'. (3 Marks)

(b) 'Connected taxable persons'. (4 Marks)

(c) 'Comparable uncontrolled transaction. (4 Marks)

(d) Obligations of permanent establishment to prepare and submit relevant documents to the relevant tax authorities. (4 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) "Arm's Length Principle" in relation to a controlled transaction means the results of the transaction are consistent with the results that would have been realised in a transaction between independent persons dealing under the same conditions. In effect, the arm's length principle would be said to be at play where the relationship (or lack of it) existing between parties to an economic transaction, have not impacted on the prices chargeable or payable by the respective party.

Where parties to a transaction are related or otherwise connected, the transactions must be priced as with those between independent enterprises conducted in similar circumstances.

An arm's length price for a transaction is what the price of that transaction would be on the open market. The arm's length principle provides the basis for taxing income derivable from transactions between associated enterprises in most countries. This principle is further captured in Article 9 of the OECD and Model Tax Conventions as well as OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

Put differently, the arm's length principle (ALP) is the fundamental basis of worldwide transfer pricing regulations. It is set forth in Article 9 of the OECD Model Tax Convention as follows: where "Conditions are made or imposed between the two enterprises in their commercial or financial relation which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly".

(b) "Connected Taxable Persons" include, without limiting the generality hereof, persons, individuals, entities companies, partnerships, joint ventures, trusts or associations "(collectively referred to as persons' in these regulations) and including the persons referred to in: (i) sections 13(2)(d), 18(2)(b) and 22(2)(b) of the 1990 CITA; (ii) Section 15(2) of the PPTA; (iii) Section 17(3)(b) of the 1993 PITA; (iv) Article 9' of the OECD Model Tax Convention (v) Associated enterprise of the OECD guidelines.

Generally, persons are deemed connected where one person has the ability to control or influence the other person in making financial, commercial, or operational decisions or there is a third person who has the ability to control or influence, both persons in making financial, commercial or operational decisions.

Connected persons also include persons who are related, associated, or connected to one another as defined in Companies Income Tax Act, Petroleum Profits Tax Act, Personal Income Income Tax Act and Capital Gains Tax Act.

(c) "Comparable Uncontrolled Transaction" in relation to the application of a transfer pricing method to a controlled transaction, means an uncontrolled transaction which, after taking account of the comparability factors, satisfies the differences, if any, between the two transactions or between the persons undertaking the transactions which do not materially affect the financial indicator applicable under the method or where the differences do materially affect the financial indictor applicable under the method, then reasonably accurate adjustments can be made to eliminate the effects of the differences.

(d) Affected taxpayers are required to provide audited accounts for their permanent establishments or fixed base in Nigeria.

The following obligations should be carried out:

- These companies are to provide income tax computations which show the taxable profits after considering taxable revenue, tax deductible expenses and capital allowances;
- The accounts of the PE to be submitted to the FIRS must:
  - Be prepared in line with International Financial Reporting Standards (IFRS); and
  - Be audited by a Nigeria based auditor in line with International Standards on Auditing.
- Income statements or receipts and payment together with statements of financial position (balance sheet or statement of affairs) will suffice;
- Non-residents companies should pay their income taxes based on actual profits. However, based on indications from the FIRS, tax may still be assessed on the deemed profit basis at the discretion of the FIRS where the taxpayer fails to provide sufficient evidence in support of actual profit tax; and
- Companies must comply with the requirement of the TP regulations, that is, complete and submit TP declaration and disclosure forms; and provide documentation supporting the arm's length nature of the dealings between the PE and the head office or other members of the group.

EXAMINER'S REPORT

The question tests candidates' knowledge of definitions of key terminologies in transfer pricing and the documents that a permanent establishment is expected to maintain which should be forwarded to the relevant tax authorities.

Majority of the candidates attempted the question and performance was average. Most of the candidates could not explain "Comparable Uncontrolled Transaction " and the relevant documents that must be prepared by any permanent establishment for onward transmission to the relevant tax authorities.

Candidates are advised to read the Institute's Study Pack before sitting for future examinations.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

PROFESSIONAL EXAMINATION

PTE II: TAX AUDIT AND INVESTIGATION

EXAM NO………………………..……………………..…. **TIME: 3 HOURS.**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS

SHOW ALL WORKINGS.

1. You are working as a manager at the Victoria Island Micro and Small Tax Office (MSTO) of the Federal Inland Revenue Service (FIRS). You have been assigned to lead a team of tax auditors to carry out a tax audit exercise on Jeyadet Nigeria Limited.

   Extracts from the company's last audited financial statements are as listed in the Appendix below.

   Required:

   (a) Explain how you will carry out the initial analysis to determine areas of focus at the company's premises. (10 Marks)

   (b) List the matters or issues that will be discussed with the company's management and/or its representatives during the initial meeting before the commencement of the audit. (10 Marks)

   (c) Itemise possible reasons why you need to hold exit meeting with the company's management after the completion of field work. (5 Marks)

   (d) From the extracts of the financial statements, carry out a comparative analysis using Ten (10) appropriate ratios. (15 Marks)

   (Total 40 Marks)

Appendix

Jeyadet Nigeria Limited
Extracts from financial statement for the year

	2019	2018
Income statement:	**₦'000**	**₦'000**
Revenue	161,345	131,864
Cost of sales	(96,449)	(73,423)
Gross profits	64,896	58,441
Administrative expenses	(31,631)	(23,204)
Net operating profits	33,265	35,237
Interest income	7,200	4,800
Investment income	10,886	9,731
Interest expense	(4,765)	(4,391)
Profit before tax	46,586	45,377
Tax expense	(14,908)	(14,521)
Profit for the year	31,678	30,856

Dividends	(12,671)	(11,108)
Retained for the year	19,007	19,748
Retained earnings b/fwd	30,868	11,120
Retained earnings c/fwd	49,875	30,868

Statement of financial position

	2019	2018
	₦'000	**₦'000**
Non-current assets:		
Property, plant and equipment	321,357	272,108
Investments	22,531	16,693
	343,888	**288,801**
Current assets:		
Inventories	82,851	67,289
Trade receivables	65,243	50,272
Cash at hand	10,978	7,155
Bank balance	22,866	17,478
	181,938	142,194
	525,826	**430,995**
Current liabilities:		
Overdraft	49,359	37,512
Trade payables	87,355	93,533
Tax payable	25,579	28,401
Dividends payable	21,940	16,900
	184,233	176,346
Loan notes	42,770	39,537
Total Liabilities	**227,003**	**215,883**
Equity:		
Ordinary Share Capital:	20,000	20,000
Share premium	50,000	50,000
Revenue reserves	178,948	114,244
Retained earnings	49,875	30,868
Total equity	**298,823**	**215,112**
	525,826	**430,995**

SOLUTION TO QUESTION 1

(a) The focus of the initial analysis, to determine areas of the audit to concentrate on are:

(i) Draw up an audit plan which will include on outline of the work to be done, the number of staff required to carry out the audit, and the timing of doing the job;

(ii) Prepare audit checklist to be used in respect of the taxpayer to ensure that all necessary areas of audit activities are covered;

(iii) Review and evaluate the taxpayer's performance and the areas of audit focus by:

- * Review the last audit report or investigation report, if any; and
- * Review and analyse the financial statements of the taxpayer by calculating appropriate ratios over two to five years and analyse the trend.

(iv) Extract and document relevant information about the taxpayer which will include:

- * Name of the company;
- * Registered address;
- * Date of commencement of business;

* Date of registration;
* Taxpayer's identification number (TIN);
* Nature of business;
* Accounting year end;
* Particulars of directors;
* External auditors/tax consultant and their address;
* Bankers and their addresses;
* Solicitors and secretary;
* Associated companies, if any; and
* Period covered in the last audit or investigation, if any.

(b) The matters/areas to discuss with the company's management or its representatives during the initial meeting before the commencement of the audit are:

(i) Inform the taxpayer about the purpose of the audit;
(ii) Introduction of the audit team;
(iii) Confirmation of the background information of the taxpayer earlier collected;
(iv) Collection of other relevant facts that are not available in the office;
(v) Familiarisation and discussions on the company's accounting and operational systems in order to ascertain:
* Whether the accounting system is manual or computerised;
* The invoicing system in place for both sales and purchases; and
* Treatment of cash receipts, whether or not they are banked intact.
(vi) Allowing the taxpayer the opportunity to ask questions or express his/her views on the audit.
(vii) Seek the cooperation of the taxpayer in terms of providing books, records, documents and explanation where necessary;
(viii) Take a tour of the taxpayer's premises; and
(ix) Request for any outstanding tax returns (e.g. VAT, WHT etc) which the taxpayers ought to have submitted.

(c) Possible reasons why exit meeting must be held at the conclusion of the audit are to:

(i) Appreciate the company's management and or representatives for their cooperation during the audit exercise;
(ii) List and discuss other outstanding matters and documents needed to be provided by the company;
(iii) Bring to the attention of the company's management or representatives the findings of the audit exercise;
(iv) Formally inform the management of the company or its representatives that the visit to the company's premises has formally ended;
(v) Determine whether the company agrees with the result of the audit exercise.

(d) Ratios analysis of Jayadet Nigeria Limited;

(i) Gross profit margin

2018 $\frac{58,441}{131,864} \times \frac{100}{1}$

= 44.3%

2019 $\frac{64,896}{161,345} \times \frac{100}{1}$

= 40.2%

(ii) Net operating profit margin:

2018 $\frac{35,237}{131,864} \times \frac{100}{1}$

= 26.7%

2019 $\frac{35,896}{161,345} \times \frac{100}{1}$

= 40.2%

(iii) Return on assets (ROA):

2018 $\frac{\text{PBT}}{\text{Total Assets}}$ $\frac{45,377}{430,995} \times \frac{100}{1}$

= 10.5%

2019 $\frac{\text{PBT}}{\text{Total assets}}$ $\frac{46,586}{525,826} \times \frac{100}{1}$

= 8.9%

(iv) Return on capital employed (ROCE):

2018 $\frac{49,768}{254,649} \times \frac{100}{1}$

= 19.5%

2019 $\frac{51,351}{343,593} \times \frac{100}{1}$

= 14.9%

(v) Assets turnover:

2018 $\frac{\text{Turnover}}{\text{Total assets}}$ $\frac{131,864}{430,995}$

= 0.3: 1.0

2019 $\frac{\text{Turnover}}{\text{Total Assets}}$ = $\frac{161,345}{525,826}$

= 0.3: 1.0

(vi) Accounts receivable period (assuming all sales were on credit).

2018 $\frac{\text{Trade receivable}}{\text{Sales}}$ $\frac{50,272}{131,864} \times \frac{365}{1}$

= 139 days

2019 $\frac{\text{Trade receivable}}{\text{Sales}}$ $\frac{65,243}{161,345} \times \frac{365}{1}$

= 148 days

(vii) Accounts payable period:

2018 $\frac{93,533}{73,423} \times \frac{365}{1}$

= 465 days

2019 $\frac{87,355}{96,449} \times 365$

= 331 days

(viii) Current ratio:

2019 $\frac{181,938}{184,233}$ = 0.99: 1.00

2018 $\frac{142,194}{176,346}$ = 0.81 : 1.00

(ix) Acid test:

2019 $\frac{99,087}{184,233}$ = 0.54 : 1.00

2018 $\frac{74,905}{176,346}$ = 0.42 : 1.00

(x) Debt/Equity ratio:

2018 $\frac{39,537}{254,649} \times \frac{100}{1}$ = 15.5%

2019 $\frac{42,770}{343,593} \times \frac{100}{1}$ = 12.4%

(xi) Interest cover:

2018 $\frac{PBIT}{Interest}$ $\frac{49,768}{4,391}$ = 11.3times

2019 $\frac{PBIT}{Interest}$ $\frac{51,351}{4,765}$ = 10.8times

EXAMINER'S REPORT

This is a compulsory question that tests the candidates' understanding of how to carry out a tax audit exercise in an organisation. It required candidates to explain how initial analysis of the company's premises be carried out; issues to be discussed with the company's management before commencement of audit reasons for holding exit meeting and also and to carry out a comparative analysis using appropriate ratios. Majority of the candidates attempted the question. However, only about 10% of them scored above 50% of marks obtainable.

The commonest pitfalls was lack of understanding of how to carry out on effective tax audit.

Candidates are advised to ensure adequate coverage of the syllabus when preparing for future examinations.

2. Audit files are normally classified into two:

Required:

(a) Explain briefly the Two (2) types of file that are kept on tax audit assignments. (5 Marks)

(b) List Five (5) information that can be found in each of the two files. (10 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) The two types of file normally kept on tax audit are the permanent file and the current file. Permanent File: This file normally contains documents and matters of continuing importance which will be required for more than one audit period.

Current File: The current file contains matters relating only to the current audit.

(b) (i) Information in the permanent file includes:

* Statutory documents governing the existence, conduct, accounts and audit of the entity, such as, copies of incorporation documents, companies governance code, stock exchange regulations, security and exchange regulations, etc.
* The operational instructions, rules and regulations of the enterprise;
* Copies of documents of continuing importance to the auditors, such as, trade licence, royalties, loan agreements, debenture deeds, etc;
* Addresses – the registered office and all other business locations;
* The taxpayer's organisation chart, showing the various departments, section and authority lines;
* List of accounting matters of importance, such as, accounting policies, accounting manuals, internal control systems, etc;
* A list of the entity's directors and their shareholdings.
* Notes of interviews and correspondence in respect of internal control matters and past management letters;
* A list of the company's bankers, solicitors, stockbrokers, etc;
* A list of the company's properties and investments with notes on verification; and
* A copy of important agreements, such as rent agreements, loan agreements etc.

(ii) Information in current tax audit file includes:

* Synopsis of audit instruction;
* Source of audit trigger;
* Case allocation memo/minutes;
* Extraction of relevant/tax information about the carry any including its background information;
* Analytical review of taxpayers returns;
* Audit plan including the audit planning memorandum;
* Scope and extent of audit coverage, including the audit programme;
* Correspondences with other FIRS tax offices and state tax offices;
* Correspondences with taxpayers;
* Correspondence with third parties;
* Minutes of meeting, pre-audit meetings, reconciliation meetings;
* Interim and final reports;

* Tax status report, including the related tax computations and financial statements;
* Letter of intent;
* Assessment notices;
* Settlement of tax liabilities;
* Reconciliation with regards to the tax administration which were forwarded to headquarters; and
* Case closure reports and documents.

EXAMINER'S REPORT

The question tests the candidates' knowledge of types of file that are kept on tax audit assignments and information to be found on those files. Most of the candidates attempted the question, and performance was below average.

The commonest pitfalls noticed was the inability of the candidates to properly define these files and list the contents of the files.

Candidates are advised to study very well the Institute's study pack when preparing for future examinations.

3. Self-Assessment Scheme has been part of the Nigerian Tax System for a long time. However, the use of self-assessment may result in tax audit to verify the returns filed by a taxpayer.

Required:

(a) List the components of a tax return normally filed by taxpayers. (5 Marks)

(b) State any Five (5) objectives of a tax audit exercise. (5 Marks)

(c) Explain the most common independent confirmation with respect to tax audit evidence. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) The components of a tax return normally filed by taxpayers are:

(i) A completed self-assessment returns form-tax form IR3C-4 coy. 3;
(ii) Audited financial statements;
(iii) Schedule of tax computation for the period;
(iv) Schedule of capital allowance computation for the period;
(v) Bank cheque or treasury receipt for the payment of the self-computed tax liability; and
(vi) Signed declaration by the taxpayer or the company director/secretary that the information contained in the tax returns is true to the best of his knowledge.

(b) The objectives of a good tax audit are to:

(i) Determine whether or not the taxpayer have complied with the relevant tax laws and if not, to take necessary actions in line with the provision of the tax laws;
(ii) Discover existence of tax fraud and recommend this for tax investigation;
(iii) Discourage tax evasion so as to enhance higher tax compliance rate;
(iv) Educate taxpayers on the various aspects of the tax laws;
(v) Encourage voluntary compliance with tax laws and regulations;
(vi) Create taxpayers awareness of their rights and responsibilities under the provisions of the tax laws and regulations;
(vii) Determine whether all the applicable tax legislation have been complied with;

(viii) Enable tax authority to collect further information on the taxpayer, especially information of a permanent nature;
(ix) Review the taxpayer's tax strategy; and
(x) Ascertain the taxpayer's proper tax liability.

(c) External confirmation is seeking from other sources external to the entity, details in the taxpayer accounting records, such as confirmation of bank balances from the bank directly or information of receivable balances from the entity's customers directly.

For tax audit purposes, the commonest and most important external confirmation is collection of bank statements of the taxpayer's bank accounts directly from the banks. These will assist the tax auditor to confirm whether or not the accounting records of the taxpayer includes the transaction that occurred during the period.

EXAMINER'S REPORT

The question tests the candidates' knowledge of components of a tax return normally filed by taxpayers, objectives of a tax audit exercise, and common independent confirmation with respect to tax audit evidence. Most of the candidates attempted the question, and more than 50% of them scoring about 50% of total marks obtainable. The commonest pitfalls of the candidates was their misunderstanding of the questions.

Candidates are advised that they should ensure adequate coverage of the syllabus when preparing for future examinations.

4. The tax authority may initiate tax audit exercise as a result of certain circumstances.

Required:

(a) List Five (5) of such circumstances. (5 Marks)

(b) A tax auditor will normally need to have tax audit programme for him to carry out an effective tax audit exercise.

Required:

(i) Explain the term "tax audit programme". (5 Marks)

(ii) List Five (5) objectives of tax audit programme. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) Circumstance that can make the tax authority to initiate tax audit are:
(i) Genuine information received from intelligence or the risks departments, or external sources about taxpayers;
(ii) Taxpayers with refund claims;
(iii) Returns showing refunds especially arising from excess withholding tax or VAT;
(iv) Taxpayers making nil returns or reporting losses on a continuous basis;
(v) Taxpayer with poor adequacy ratios;
(vi) Claims under double taxation agreement;
(vii) Based on routine sectorial/industry audit;
(viii) Case referrals as a result of desk review; and
(ix) Deviation from inter-firm comparison.

(b) Audit Programme

(i) A tax audit programme is a schedule of audit work expected to be performed during an audit exercise, on each items of the accounts, such as income or revenue, expenditures, purchase, inventory, wages and salaries, non-current assets and liabilities. It is usually prepared before the commencement of the tax audit exercise.

It summarises all the steps required to be taken in carrying out the audit exercise to ascertain the taxpayer's compliance with subsisting legislation.

(ii) Objectives of audit programme are to:

* Provide details of work done by each member of the audit team;
* Provide information on how the audit work has been completed;
* Provide records of each audit staff member's responsibility and the stage of work done;
* Make effective coordination and control of the audit work easier;
* Help to focus the audit team efforts on the core elements of the assignment;
* Serve as a guide to members of audit team during the audit exercise.

EXAMINER'S REPORT

The question tests candidates' knowledge of circumstances for the tax authority to initiate tax audit exercise and also to explain the term tax audit programme and its objectives. A very popular question with about 99.5% of candidates attempting the question.

Candidates demonstrated good knowledge of the question and performance was very good.

5. State the provisions of the following Nigerian tax statutes that empowered the relevant tax authorities to carry out tax audit and investigation.

(a) Companies Income Tax Act (CITA). (5 Marks)

(b) Personal Income Tax Act (PITA). (5 Marks)

(c) Value Added Tax Act (VATA). (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 5

(a) Companies Income Tax Act's provisions on tax audit and investigation are as follows:

Section (60) (4) provides that:

"Nothing in this section or any other provision of this act shall be constructed as preceeding the service from verifying by tax audit or investigation any matter relating to any return or entry in any book, document, accounts, including those stored in a computer, digital or magnetic, optical or electronic media as may, from time to time, be specified in any guideline by the service".

Section 66 (1) further provides that;

"If the Board discovers or is of the opinion at any time that any company liable to tax has not been assessed or has assessed at a less amount than that which ought to have been charged, the Board may, within the year of assessment or within six years after the expiration thereof and as often as may be necessary, assess such company at such amount or additional amount, as ought to have been charged, and the provision of this act as to notice of assessment, appeal and other proceedings shall apply to such assessment or additional assessment and to tax charged the reminder".

Provided that where any form of fraud, willful or neglect has been committed by or on behalf of any company in connection with any tax imposed under this act or under the Companies Income Tax Act, the Board may at any time and as often as may be necessary, assess such company at such amount or additional amount as may be necessary for the purpose of making good any loss of tax attributable to the board.

(b) The provision of the Personal Income Tax Act on tax audit and investigation are as follows: Section 55 stipulates that:

(i) "If the relevant tax authority discovers or is of the opinion at any time that a taxable person liable to income tax has not been assessed or has been assessed at a less amount than that which ought to have been charged, the relevant tax authority may, within the year of assessment or within six years after the expiration thereof and as often as may be necessary assess the taxable person at such amount or additional amount as ought to have been charged, and the provision of this act as to notice of assessment, appeal and other proceedings shall apply to that assessment or additional assessment and to the tax there under".

(ii) For the purpose of computing under subsection (1) of this section the amount or the additional amount which ought to have been charged, all relevant facts consistent with paragraph (b) of the provision to section 66 (2) of this act shall be taken into account whether or not known when a previous assessment on the same taxable person for the year was being made or could have been made; provided that where any form of fraud, willful default or neglect has been committed by or on behalf of a taxable person in connection with any tax imposed under this act, the relevant tax authority may at any time and as often as may be necessary assess that taxable person at such amount or additional amount as may be necessary for the purpose of making good any loss of tax attributable to the fraud, wilful default or neglect.

(c) The provisions of the Value Added Tax Act on audit and investigation are:
Section 39 stipulates that:
"An authorised officer may at any time enter without warrant any premises upon which he has reasonable grounds to believe that a person is carrying on business in order to ascertain whether this act is being complied with (whether on the part of the occupier of the premises or any other person) and on entry may carry out such inspections and make such requirements as may be specified by the Board.

Where an authorised officer enters any premises in exercise of the power conferred on him by subsection (1) of this section he may take with him such persons as he considers necessary for carrying out this functions under this act".

EXAMINER'S REPORT

This question requires the candidates to state the provisions of some Nigerian tax statutes that empowered the relevant tax authorities to carry out tax audit and investigation. Few of the candidates attempted the question and performance was poor.

The commonest pitfalls in answering the question is that, majority of the candidates misunderstood the question because of failure to distinguish between the enabling provisions from powers and duties of relevant tax authorities.

Candidates are advised to familarise themselves with the provisions of the various tax statutes when preparing for future examinations.

6. You have been assigned by your Tax Controller to lead a team of tax auditors to carry out a tax audit of Bellema Nigeria Limited, a manufacturing company.

Required:

(a) State the steps you will follow in carrying out the tax audit and submit your final report to the office. (10 Marks)

(b) Itemise Five (5) essential documents you will request the company to produce, which will assist in carrying out an effective audit exercise. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 6

(a) The steps to follow in carrying out tax audit of Bellema Nigeria Limited are:

- (i) Preliminary review of Bellema Nigeria Limited's tax file, e.g. assessments, collections, value added tax etc;
- (ii) Drawing up of the audit plan;
- (iii) Send notification letter to Bellema Nigeria Limited;
- (iv) Hold a pre-audit meeting on the premises of Bellema Nigeria Limited on the commencement of the audit;
- (v) Conduct the actual audit;
- (vi) Hold post-audit or exit meeting before leaving the premises of Bellema Nigeria Limited at the completion of the audit;
- (vii) Prepare interim report and submit to management;
- (viii) Hold reconciliation meeting;
- (ix) Send letter of intent and raise assessment notice; and
- (x) Write final audit report.

(b) Essential documents to request for from the management of Bellema Nigeria Limited for the audit are:

- (i) Audited accounts of the relevant years;
- (ii) Management accounts of the relevant years;
- (iii) Year end final trial balance of the relevant years;
- (iv) General ledger/ledger print out;
- (v) Sales invoice file;
- (vi) Purchases invoice file;
- (vii) Import documents, if any;
- (viii) Value added tax files;
- (ix) Withholding tax file;
- (x) Capital gains tax records;
- (xi) Cash books and payment vouchers;
- (xii) Audit adjustment journals;
- (xiii) Minutes of board of directors meetings;
- (xiv) Bank statements; and
- (xv) Previous tax audit/investigation reports.

EXAMINER'S REPORT

The question tests the candidates' knowledge of the steps to follow in carrying out tax audit of an organisation and to itemise essential documents to be collected in carrying out an effective audit exercise. Most of the candidates attempted the question and performance was very good.

7. Explain indepth, the concept of taxpayer's and Industry's Risk Profiling in a tax audit exercise. (15 Marks)

SOLUTION TO QUESTION 7

Taxpayer and industry profiling are risk assessment techniques in risk-based tax audit. It involves an understanding of the taxpayer and its industry environment. Taxpayer profiling is defined as "the development of a thorough understanding of the taxpayer's compliance behaviour and their business. It involves carrying out of the following tasks by the tax auditor:

(a) Review of basic tax information which includes determination whether:
   (i) The return was filed on due date;
   (ii) Required schedules are completed;
   (iii) Taxes are not overdue; and
   (iv) Financial statements have been filed with other statutory authorities.

(b) Review the taxable income and tax payable calculated by the taxpayer, which include determination of whether:
   (i) Carry over loss, exempted income and deducted income were properly applied;
   (ii) Accumulated income tax is properly calculated; and
   (iii) The tax payable and tax credit are properly calculated;

(c) Review financial statements, which include:
   (i) Trend analysis on major accounts; and
   (ii) Calculation of ratios.

(d) Review changes in paid-up capital and major shareholders;

(e) Review inventories movements between affiliated companies;

(f) Review of transfer pricing issues if the taxpayer is a member of a multinational, which involves:
   (i) Review transfer pricing policy;
   (ii) Review the flow of limit to or through tax havens;
   (iii) Examine arm's length; and
   (iv) Research any advance pricing arrangements.

(g) Review the taxpayer, which includes examination of the taxpayer's;
   (i) Organisation chart;
   (ii) Major products;
   (iii) Functions of each department;
   (iv) Documentation relating to tax planning strategies; and
   (v) Taxpayer's use of e-commerce.

(h) Review of third party information, which includes, quarterly returns from banks, returns from customers etc.

(i) Review of the current industry environment of the taxpayer, which includes:
   (i) The current market trend of the products;
   (ii) The position of the taxpayer in the market place; and
   (iii) The average industry indices;

(j) The level of other pre-contact work will largely depend on the complexity of the affairs of the taxpayer concerned, and the tax risks identified during risk assessment. However, these can be categorised into four general headings as follows:
   (i) Review of unreported income;
   (ii) Intelligence gathering;
   (iii) Review of prior history; and
   (iv) Returns preparer performance, e.g. the tax consultant of the taxpayer that filed the returns.

EXAMINER'S REPORT

The question requires the candidates' to explain the concept of taxpayer's and industry's risk profiling in a tax audit exercise. Few of the candidates attempted the question, and performance was poor.

The commonest pitfall was the fact that the candidates were trying to discuss risk analysis instead of the profiling/profile of the tax payer as related to tax audit.

Candidates are advised to prepare adequately for future examinations and make use of the Institute's study pack.