THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2021 PATHFINDERR FOR PTE II.

INCOME TAX FOR SPECILAIZED BUSINESS

WEDNESDAY 14TH APRIL, 2021 **EXAM NO................................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

SHOW ALL WORKINGS. **TIME: 3 HOURS.**

1. Rivers Oil Producing Company Limited is engaged in petroleum operations. Following a disagreement between the Board of Directors of the company and the external auditors as to the company's tax liability as at 31 December, 2019, you were appointed as the tax consultant to review the tax position of the company as at that date. You have been given the following information in respect of the company's operations for the year ended 31 December, 2019.

(a) The company produced 600,000 barrels of crude oil during the year of which 8% was sold in the local market at the rate of ₦45 per barrel, while the rest was exported.

(b) The API gravity of crude oil exported was 30^0. The posted price of crude oil was $25 per barrel at the standard API gravity of 35^0. For every degree increase or decrease in API gravity above or below the standard API gravity, the price is increased or decreased by $0.05. The rate of exchange was ₦100 to $1.

(c) Expenses incurred by the company:

	₦
Administration expenses	124,400,000
Production expenses	396,000,000
Depreciation	37,600,000
Cost of information on the existence and extent of petroleum deposits	4,200,000
Cost of drilling three appraisal wells	11,450,000
Non-productive rent	3,120,000
Royalty on export sales	68,310,000
Royalty on local sales	108,000
Customs duties	66,000
Intangible drilling cost	17,400,000
Donations	6,000,000

Repairs and maintenance	105,600,000

(d) Losses in respect of petroleum operations brought forward are as follows:

2014	3,000,000
2015	12,000,000
2016	8,000,000
2017	7,000,000
2018	2,000,000
	32,000,000

(e) Capital allowances brought forward 14,356,000

(f) Schedule of qualifying capital expenditure with years of acquisitions:

Asset	**Year**	**Onshore**	**Between 100m & 200m**	**Above 200m**
		₦	**₦**	**₦**
Building	2011	5,000,000		
Pipeline	2014		15,000,000	
Plant	2015	20,000,000		
Pipeline	2016	10,000,000		
Pipeline	2019	12,000,000	8,000,000	6,000,000

(h) The company had made payment of ₦165,000,000 from the estimated returns filed with Federal Inland Revenue Service in 2019.

Required:
Write a letter to the Managing Director of the company to advise him of the company's tax liability for the relevant accounting period. (40 Marks)

Note: All computations should be in Naira.

SOLUTION TO QUESTION 1

Dogo Bassi & Co.
(Chartered Tax Practitioners)
No 8 Buhari Street,
Alapere, Lagos.

14 April, 2021

The Managing Director,
Rivers Oil Producing Company Limited
Port Harcourt,
Rivers State

Dear Sir,

REVIEW OF PETROLEUM PROFITS TAX LIABILITY AS AT 31 DECEMBER, 2019

Further to your letter on the above subject matter we attach herewith our computation of your company's tax liability for 2019 year assessment.
Our computation was based on the provisions of the Petroleum Profits Tax Act, Cap, P13, LFN 2004, Tertiary Education Trust Fund (Establishment) Act, 2011 and the information extracted from the company's accounts for the year ended 31 December, 2019.

The computation has shown that the assessable profit, chargeable profit and chargeable tax (petroleum profits tax) are ₦601,688,889; ₦573,332,889 and ₦487,332,956 respectively. Since your company has already made payment of tax by instalments totalling. ₦165,000,000 based on the return of estimated tax as required by law, you will now be required to pay the final instalment of the sum of ₦322,332,956. The final instalment is the amount of tax assessed for 2019 less the amount of monthly instalment already paid. The company is also liable to pay tertiary education tax of ₦12,037,778.

We advise that the company's accounts and particulars should be submitted to FIRS on or before 31 May, 2020 in compliance with the five months' deadline for submission of accounts after year end. Also note that the final instalment of the petroleum profits tax is due and payable within twenty-one days after the service of the notice of assessment of tax for the accounting period, while the tertiary education tax is due and payable within sixty days after the FIRS has served notice of the assessment on the company.

We thank you for appointing us as your tax consultant and enclose herewith our bill of ₦1million for the assignment. Should you require further explanation or clarification, please do not hesitate to contact us.

Yours faithfully,
for: Dogo Bassi & Co.

Fillibus Bassi
Principal Partner

Appendix

Rivers Oil Producing Company Limited
Computation of Petroleum Profits Tax for 2019
Accounting Period

	₦	₦
Value of crude oil sold (w1):		
- Export sales		1,366,200,000
- Local sales		2,160,000
		1,368,360,000
Less: Allowable expenses:		
Administration expenses	124,400,000	
Production expenses	396,000,000	
Cost of drilling first 2 appraisal wells (2/3 x 11,450,000)	7,633,333	
Non-productive rent	3,120,000	
Royalty on export sales	68,310,000	

Royalty on local sales	108,000	
Custom duties	66,000	
Intangible drilling costs	17,400,000	
Repairs & maintenances	105,600,000	
	722,637,333	
Tertiary education tax (w2)	12,033,778	734,671,111
Adjusted profit		633,688,889
Less: Losses brought forward		32,000,000
Assessable profit		601,688,889
Less: Capital allowance – lower of capital allowances brought forward	14,356,000	
Petroleum investment allowance (w3)	3,000,000	
Annual allowance for the year (w4)	11,000,000	
	28,356,000	(28,356,000)
And		
85% of assessable profit (i.e. 85% x 601,688,889)	511,435,556	
Less 170% of PIA (i.e. 170% x 3,000,000)	5,100,000	
	505,363,334	
Chargeable profit		573,332,889
Assessable tax = 85% of chargeable profit (i.e. 85% x 573,332,889)		487,332,956
Chargeable tax		487,332,956
Less: PPT instalment paid in 2019		(165,000,000)
Final PPT instalment (13th instalment)		322,332,956

Workings

(W1) Computation of value of crude oil sold

Posted price:	$	$
Posted price at standard API gravity		25.00
Standard API gravity 35°		
API gravity of crude oil exported 30°		
Decrease in API gravity 5°	0.05	(0.25)
Posted price per barrel in $		24.75
Rate of exchange – ₦100 = $1		
Posted price per barrel in naira ($24.75 x 100)		₦2,475

Value of crude oil sold	₦	₦
Export sales – 600,000 bbls x 92% x ₦2475 per bbl		1,366,200,000
Local sales – 600,000 bbls x 8% x ₦45 bbl		2,160,000
		1,368,360,000

(W2) Computation of Tertiary Education Tax	**₦**
Value of crude oil sold	1,368,360,000
Less allowable expenses (excluding education tax)	(722,637,333)
Adjusted profit before education tax	645,722,667
Less losses brought forward	(32,000,000)
Assessable profit before education tax	613,722,667
Tertiary education tax – 2/102 x 613,722,667	12,033,778

(W3) Computation of petroleum investment allowance (PIA)

Water Depth	Qualifying Expenditure		PIA
	₦	%	₦
Onshore	12,000,000	5	600,000
Between 100 – 200 meters	8,000,000	15	1,200,000
Above 200 metres	6,000,000	20	1,200,000
			3,000,000

(W4) Computation of Annual Allowance

Asset	Year of Acquisition	Qualifying Expenditure	Annual %	Allowance ₦
Building	2011	5,000,000	0 (9th year)	--
Pipeline	2014	15,000,000	0 (6th year)	--
Plant	2015	20,000,000	19 (5th year)	3,800,000
Pipeline	2016	10,000,000	20 (4th year)	2,000,000
Pipeline	2019	26,000,000	20 (1st year)	5,200,000
				11,000,000

EXAMINER'S REPORT

The question tests candidates' knowledge of the computation of tax liability of a company that is into the sale of crude oil.

Candidates' performance was very good as more than 95% of the candidates attempted the question and 70% of the candidates scored above 50% of the marks allotted to the question.

Candidates are advised to make a good use of the Institute's Study Pack and previous examinations' Pathfinders.

2. (a) Within the context of mining and solid mineral operations.

(i) Explain the term "deferment of royalty". (2 Marks)

(ii) Under what circumstances will deferment of royalty be granted. (2 Marks)

(b) Chinedu Mining Company Limited commenced granite mining operations in January 2019. It submitted accounts for the year ended 31 December, 2019 in March 2020 for both Companies Income Tax and Mineral royalties. Prior to the submission of this accounts, the company had not submitted any document to the Tax Authority except those which it used in opening the company's tax file. During the year under review, the company decided to expand the business as part of its strategy to capture a larger market within Mining Operation by buying a quarry site. The following extract of the company's financial statements was presented to you.

	₦	₦
Revenue from mining operation		135,300,650
Less:		
Direct exploration expenses	50,450,150	
Selling & marketing expenses	2,895,256	
Financial charges	2,540,650	
Administrative expenses	4,675,875	
Donations	85,950	
Overseas expenses	950,560	
Cost of fabricating spare parts	850,000	
Depreciation	1,875,955	
Cost of valuation of property	2,560,000	66,884,396
Net Profit		68,416,254

The following information were also provided:

(a) The figure of donations include ₦20,000 made to a non-charitable organisation.
(b) Capital allowances agreed with the Tax Authority is ₦11,885,750.
(c) Overseas travel relates to air fares and other expenses incurred by the wife and children of the Managing Director during summer holiday abroad.
(d) Recoverable insurance claim of ₦750,000 is included in administrative expenses.
(e) The company won 65,000 metric tonnes of granite, out of which a total of 48,500 metric tonnes were sold as at the end of the year.
(f) The market price of granite is ₦5,500 per tonne.
(g) The royalty rate is 5%.

You are required to calculate:

(i) The tax liability of the company for the relevant assessment year. (8 Marks)

(ii) The royalty payable. (3 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) (i) Deferment of Royalty Payment

Deferment of royalty payment on mineral products occur in a situation where the minister grant the deferment to a producer of mineral product for a particular period in the national interest and that of the producer. Such deferment may be due to cash flow problems of the producer as a result of some uncontrollable disaster.

(ii) > Circumstances under which deferment of royalty can be granted

Deferment of royalty payment may be granted to preserve jobs and to lessen costly economic impact which pressure to pay the royalty on the producer may cause the latter to close down the mine site when it found out it has no capability to continue operation. Tax policy makers will now see the need to defer the royalty payment so as to keep the company operational.

- When there are circumstances beyond the control of the company that prevented them from working. For example, the issue of Covid-19 pandemic.

(b) Chinedu Mining Company Limited

(i) Computation of Tax liability for 2020 Tax Assessment year

	₦	₦
Net profit as per accounts		68,416,254
Add back: Donations	20,000	
Overseas expenses	950,560	
Recoverable insurance claim	750,000	
Depreciation	1,875,955	
Cost of valuation of property	2,560,000	
		6,156,515
Assessable Profit		74,572,769
Deduct: Capital allowances		(11,885,750)
Chargeable Profit		62,687,019

Tax liability = ₦62,687,019 x 30% = ₦18,806,106

Education tax = Assessable profit x 2%
= ₦74,572,769 x 2% = ₦1,491,455.40

(ii) Computation of Royalty for the year ended 31/12/2015

Total production for the year	65,000 M/tonnes
Volume of granite sold	48,500 tonnes
Market price per tonne	₦5,500

Value of tonnage sold = 48,500 x ₦5,500
= ₦266,750,000

Royalty payable is 5% x ₦266,750,000
= ₦13,337,500

EXAMINER'S REPORT

The question tests "Deferment of Royalty" and circumstances under which it is granted. It also tests the computation of tax liability and royalty payable by mining company.

Majority of the candidates attempted the question and performance was fair. Part 'a' of the question on "Deferment of Royalty" and circumstances under which it is granted appears strange to the candidates, while part 'b' on tax computation and royalty was, however, well answered and this assisted few of the candidates to score good marks.

Candidates' generally do not understand the royalty deferment question resulting in poor results. They however appeared to understand and perform fairly well in the tax computation and royalty section.

Candidates' are advised to ensure adequate preparation for the professional level final paper by ensuring that they cover all sections of the syllabus.

3. (a) Discuss the methods of assessing to tax the profit of a foreign company engaged in cable or wireless undertakings. (7 Marks)

(b) The following is the income statement of Prosperity Unit Trust Scheme for the year ended 31 December, 2020.

	₦000	₦000	₦000
Investment income:			
Dividend received (gross)			2,900,000
Bank interest received (gross)			1,450,000
Rent received (gross)			1,500,000
Other income (profit on sale of fixed asset)			50,000
			5,900,000
Less expenses:			
Staff salaries		1,600,000	
Managers' remuneration		700,000	
Depreciation		45,000	
Miscellaneous expenses:			
Preliminary expenses	60,000		
Diminution in the value of investments	100,000		
Subscription to the Association of Unit Trust Schemes	5,000		
Reserve for future investment	350,000		
Fine for contravention of financial regulations	7,000	522,000	2,867,000
Net profit			3,033,000

Required:
Compute the assessable profit of Prosperity Unit Trust Scheme for the relevant year of assessment. Withholding tax had been deducted at source from the investment income. (8 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) Methods of assessing the profit of a foreign company engaged in cable or wireless undertakings

(i) The company is assessable to tax on a preceding year basis.

(ii) The company is assessable to tax as if it operated ships or aircrafts. Therefore, the provisions of CITA in respect of a foreign shipping or airline shall apply mutatis mutandis to the computation of the company's profits deemed to be derived from Nigeria as though the transmission of messages to places outside Nigeria were equivalent to the shipping or loading of passengers, mails, livestock or goods in Nigeria.

(iii) The profit or loss of the company deemed to be derived from Nigeria is the full profit or loss arising from the transmission of messages to places outside Nigeria.

(iv) If the FIRS is satisfied that the tax authority of the country in which the cable or wireless company is registered computes and assesses profits or loss on a basis not materially different from that prescribed by CITA and the foreign tax authority certifies both the adjusted profit ratio and the depreciation ratio, the profits or loss of the company liable to tax in Nigeria is computed by applying the adjusted profit ratio to the total sums receivable in respect of the transmission of messages to places outside Nigeria. An allowance is granted in lieu of capital allowance and this is computed by applying the depreciation ratio to the total sums receivable in respect of the transmission of messages to places outside Nigeria.

(ii) The adjusted profit ratio is the ratio of profit or loss before depreciation of an accounting period to the total sums receivable in respect of the transmission of messages. The depreciation ratio is the ratio of depreciation for an accounting period to the total sums receivable in respect of the transmission of messages.

(iii) If the FIRS is not satisfied with the foreign tax authority's basis of computing and assessing profits or loss and the foreign tax authority's certification of the profit or loss ratio and the depreciation ratio, 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 transmission of messages to places outside Nigeria.

(iv) The tax payable for any year of assessment shall not be less than two per cent of the full sums receivable in respect of the transmission of messages to places outside Nigeria.

(b) Prosperity Unit Trust Scheme
Computation of Assessable Profit for 2021 Year of Assessment

	₦000	₦000
Net profit per accounts		3,033,000
Less:		
Dividend received (franked investment income)	2,900,000	
Profit on sale of fixed asset	50,000	(2,950,000)
		83,000
Add disallowable deductions:		
Depreciation	45,000	
Preliminary expenses	60,000	
Diminution in the value of investments	100,000	
Reserve for future investment	350,000	
Fine for contravention of financial regulations	7,000	562,000
Assessable profit		645,000

Notes:

(a) Dividend received is a franked investment income. It is not subject to further tax, hence, it is excluded from the assessable profit.

(b) Withholding tax deducted at source from rent and interest is available as set-off against tax assessment of the year of assessment.

EXAMINER'S REPORT

The question tests the computation of assessable profit of a unit trust.

Candidates' performance was very good as about 95% of the candidates that attempted the question scored above 50% of the allotted marks.

Candidates lack understanding of the requirement for question 3a while 3b was well understood though some got the calculation wrongly. About 80% of the candidates did not understand part 3a of the question.

The commonest pitfalls are:
Candidates' mistaken "basis of assessment" of a foreign company engaged in cable or wireless undertakings for steps involved in the computation of assessable profit; and candidates provided formulas for computation rather than definition of terms and explanations of calculations.

Candidates are advised to always read wide when preparing for future examinations.

4. (a) State the tax implications where a trade or business previously carried on in Nigeria by a foreign company is carried on by a reconstituted company incorporated under the Companies and Allied Matters Act. (5 Marks)

(b) East Limited and West Limited (two unrelated companies) merged in January 2014 to form a new enlarged company, East & West Plc. The trading results of the companies, as adjusted for income tax purposes, were as follows:

	East Limited	**West Limited**	**East & West Plc**
	₦	**₦**	**₦**
Year to 31st December, 2011	2,100,000	3,300,000	
Year to 31st December, 2012	2,500,000	2,200,000	
Year to 31st December, 2013	3,100,000	4,500,000	
Year to 31st December, 2014			5,000,000
Year to 31st December, 2015			8,000,000
Year to 31st December, 2016			9,000,000

Required:
Compute the assessable profits of the companies for the relevant years of assessment. (10 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) Where a trade or business previously carried on in Nigeria by a foreign company is carried on by a reconstituted company incorporated under the Companies and Allied Matters Act 2020 to carry on such trade or business and the assets employed in Nigeria by the foreign company in the trade or business vest in the reconstituted company, then the following provisions of section 29(10) of CITA shall have effect:

(i) the commencement and cessation provisions shall not apply to the trade or business carried on by the reconstituted company;
(ii) the assets vested in the reconstituted shall be deemed to have been sold to it, on the day of the incorporation of that company, for an amount equal to the residue of qualifying expenditure thereon on the day following the day of cessation of the foreign company's trade or business;
(iii) the reconstituted company shall not be entitled to any initial allowance on those assets and shall be deemed to have received all capital allowances given to the foreign company in respect of those assets; and
(iv) any unrelieved loss of the foreign company in the trade or business previously carried on by it in Nigeria shall be deemed to be a loss incurred by the reconstituted company during the year of assessment in which its trade or

business commenced. The loss shall be deducted from the assessable profits of the reconstituted company provided that:

- the reconstituted company can prove to the satisfaction of the most senior officer (i.e. director) in the Industrial Inspectorate Division of the Federal Ministry of Industry that the loss was not the result of any damage or destruction arising from the Nigerian civil war;
- if the loss was as a result of any damage or destruction arising from the Nigerian civil war, the National Council of Ministers has directed that a deduction should be made in respect of the loss to the extent specified in the direction;
- within three years after the incorporation of the reconstituted company, a claim for the loss relief is lodged by the reconstituted company with the director and a copy of the claim is forwarded by the company to the FIRS; and
- the loss shall be deducted from the assessable profits, if any, of the reconstituted company for the first year of assessment and, so far as it cannot be so made, then from the assessable profits of the next year of assessment, and so on but no deduction shall be made against the assessable profits of the company after the fourth year from the commencement of such business.

(b) Computation of Assessable Profits of the Companies

East Limited

Year of Assessment	Basis Period	Assessable	Profits
2012	(Penultimate Year)	₦	₦
	Either preceding year basis: 1/1/11-31/12/11	2,100,000	
	Or actual year basis: 1/1/12 - 31/12/12	2,500,000	2,500,000
	whichever is higher		
2013	(Ultimate Year)		
	Actual year basis: 1/1/13 - 31/12/13		3,100,000

West Limited

Year of Assessment	Basis Period	Assessable	Profits
2012	(Penultimate Year)	₦	₦
	Either preceding year basis: 1/1/11 - 31/12/11	3,300,000	
	Or actual year basis: 1/1/12 - 31/12/12	2,200,000	3,300,000
	whichever is higher		
2013	(Ultimate Year)		
	Actual year basis: 1/1/13 - 31/12/13		4,500,000

East & West Plc

(a) Original Assessment (without election)

Year of Assessment	Basis Period	Assessable Profits
2014	1/1/14 - 31/12/14	5,000,000
2015	1/1/14 - 31/12/14	5,000,000
2016	1/1/15 - 31/12/15	8,000,000
		13,000,000
2017	1/1/16 - 31/12/16	9,000,000

(b) Revised Assessment (on election)

If the right of election is exercised, the assessable profits for 2nd and 3rd assessment years will be computed on actual or current year basis as follows:

		₦
2015	1/1/15 - 31/12/15	8,000,000
2016	1/1/16 - 31/12/16	9,000,000
		17,000,000

The sum of assessable profits for the 2nd and 3rd assessment years under normal basis of assessment amounted to ₦13,000,000 which is lower than ₦17,000,000 when the right of election is exercised. Therefore, the company should not exercise its right of election to avoid incurring a higher tax liability.

Summary of Assessable Profits

Year of Assessment	**East Ltd** ₦	**West Ltd** ₦	**East & West Plc** ₦
2012	2,500,000	3,300,000	
2013	3,100,000	4,500,000	
2014			5,000,000
2015			5,000,000
2016			8,000,000
2017			9,000,000

EXAMINER'S REPORT

The question tests candidates knowledge on reconstituted company and the tax implication of such exercise.

Candidates' performance was very poor. Although about 80% of the candidates attempted the question, almost all the candidates that attempted the question scored less than the average marks allocated.

Candidates exhibited lack of understanding of reconstitution of a foreign company.

Candidates' commonest pitfall was that many of them have forgotten the principles of cessation of business.

Candidates are advised to read wide when preparing for future examinations.

5. ABC Petroleum Limited has been a major player in the Nigerian oil and gas sector for many years. The company has recently obtained a licence from the Oil and Gas Export Free Zone Authority to engage in approved enterprises within the Oil and Gas Export Free Zone. Furthermore, the company has decided to diversify into other areas such as mining and processing of lead, zinc, iron ore and gold. The Managing Director of the company has approached you as a Tax Consultant to advise him on the tax incentives or reliefs the company could take advantage of for operating in the Oil and Gas Export Free Zone and for being involved in the mining of solid minerals in Nigeria.

Required:
Present your advice to the Managing Director on the tax incentives or reliefs available to the company in line with the provisions of the Oil and Gas Free Zone Act, Cap 05, LFN 2004 and the Nigerian Minerals and Mining Act, 2007. (15 Marks)

SOLUTION TO QUESTION 5

Yellow Sisi & Co.
(Chartered Tax Practitioners)
No. 2 Brass Street
Yenogoa
Bayelsa State.

14 April, 2021

The Managing Director
ABC Petroleum Limited
Kampe Avenue
Port Harcourt

Dear Sir,

RE: TAX INCENTIVES FOR OIL AND GAS EXPORT FREE ZONE AND MINING OF SOLID MINERALS

In response to your request for our advice on the above subject matter, we state hereunder the incentives that could be taken advantage of by your company.

(a) Incentives for Oil and Gas Export Free Zone

Approved enterprises operating within export processing zones in Nigeria are granted the following incentives under the Oil and Gas Export Free Zone Act:

(i) Exemption from all federal, state and local government taxes, levies and rates;
(ii) Import of any capital goods, consumer goods, raw materials, components or articles intended to be used for the purposes of and in connection with an approved activity, including any article for the construction, alteration, reconstruction, extension or repair of premises in the Zone or for equipping such premises free of customs duty;
(iii) Exemption from legislative provisions pertaining to taxes, levies, duties and foreign exchange regulations;
(iv) Repatriation of foreign capital investment in the Zone at any time with capital appreciation of the investment;
(v) Remittance of profits and dividends earned by foreign investors in the Zone;
(vi) Exemption from the requirement for import or export licences;
(vii) Up to 25% of production may be sold in the customs territory against a valid permit and on payment of appropriate duties;
(viii) Rent-free land at construction stage. Thereafter rent shall be as determined by the Oil and Gas Export Free Zone Authority;
(ix) Up to 100% foreign ownership of business in the Zone allowable; and
(x) Foreign managers and qualified personnel may be employed by companies operating in the Zone.

(b) Incentives for Solid Minerals

Nigeria Minerals and Mining Act makes provisions for the following incentives for companies or enterprises engaged in mining operations:

(i) In determining its total profits, any licence holder is eligible to deduct from its assessable profits a capital allowance of ninety-five per cent of qualifying capital expenditure incurred in the year in which the investment is incurred:
- all certified exploration, development and processing expenditure, including feasibility study and sample assaying costs; and
- all infrastructure costs incurred regardless of ownership and replacement.

(ii) The amount of any loss incurred in mining operations shall be deducted as far as it is possible from the assessable profits of the first year of assessment after that in which the loss was incurred and in so far as it cannot be so made, then from such amounts of such assessable profits of the next year of assessment and so on up to a limit of four years after which period any unrelieved loss shall become lapse;

(iii) Exemption from payment of customs and import duties in respect of plant, machinery, equipment and accessories imported specifically and exclusively for mining operations;

(iv) Expatriate quota and resident permit in respect of the approved expatriate personnel;

(v) Personal remittance quota for expatriate personnel free from any tax imposed by any enactment for the transfer of external currency out of Nigeria;

(vi) Where the holder of a mineral title earns foreign exchange from the sale of its minerals it may be permitted by the Central Bank of Nigeria to retain in a foreign exchange domiciliary account a portion of its foreign exchange earnings for use in acquiring spare parts and other inputs required for the mining operations which would otherwise not be readily available without the use of such earning;

(vii) Free transferability of funds through the CBN in convertible currency in respect of:
- payments in respect of loan servicing where a certified foreign loan has been obtained by the holder for his mining operations; and
- the remittance of foreign capital in the event of sale or liquidation of the mining operations or any interest therein attributable to foreign investment.

(viii) A tax relief period of three years is available to a company granted mineral title and starts from the date that the company commences operation. The tax relief period may be extended by one further period of two years if the government is satisfied as to:
- the rate of expansion, standard of efficiency and level of development of the company in mineral operations for which the mineral title was granted;
- the implementation of any conditions upon which lease was granted; and
- the training and development of Nigerian personnel in the operation of the mineral concerned.

(ix) Companies engaged in the exploitation of mineral resources shall establish a tax deductible reserve for environmental protection, mine rehabilitation, reclamation and mine closure costs, provided that the appropriateness of the reserve is certified by an independent qualified person taking into account the determination made under the provisions of the Act:
- the reserve is recorded in the audited financial statements of the companies;
- tax deductibility will be restricted to actual amount incurred for the purpose of the reclamation; and

- a sum equivalent to the reserve amount is set aside every year and invested in dedicated account or trust fund managed by independent trustees appointed pursuant to the provisions of the Act.

(x) An annual capital cost indexation, whereby the unclaimed balance of capital cost is increased yearly by five per cent for mines starting production within five years from the date of enactment of the Mining Act;

(xi) The Minister of Solid Minerals may reduce or waive royalty on any mineral which the Minister is satisfied is being exported solely for the purpose of analysis or experiment or as a scientific specimen, not being in greater quantity than is reasonably necessary for that purpose;

(xii) The Minister of Solid Minerals may defer payment of royalty on any minerals for a specific period, on the approval of the Federal Executive Council; and

(xiii) Pension fund contributions by mining companies are tax deductible.

We hope you will take advantage of these incentives. Please feel free to contact us if you require further clarification or assistance.

Yours faithfully,
for: **Yellow Sisi & Co.**

Mrs Sisi Gokana
Managing Partner

EXAMINER'S REPORT

The question tests candidates presentation skills in letter form and advice to a client on the tax incentives or reliefs available to the company in line with the Oil and Gas Free Zone Act.

Candidates' performance was good as more than 90% attempted the questions and most scored above 50% of the allocated marks. However some candidates mixed up the two parts by not distinguishing one from the other.

Candidates are advised to always gather their thoughts together when answering questions in future examination.

6. New Era Bank Plc has been in business for many years. Its profit or loss account for the year ended 31 December, 2019 is as follows:

Income	**₦'000**	**₦'000**
Interest on agriculture loans		27,000
Interest on export loans		12,000
Interest on overdraft, advances and other loans.		286,500
Foreign exchange income		99,000
Lease finance income		21,000
Fee and commission		139,500
Profit on sale of fixed assets		450
		585,450
Expenses		
Interest expense	187,500	

Depreciation	20,400	
Loans and advances written off	36,000	
General provision for loan losses	12,300	
Specific provision for loans losses	10,500	
General and administrative expenses	225,900	
		492,600
Net profit		92,850

Additional information:

(i) The general and administrative expenses include the following:

	₦'000	₦'000
Salaries and wages		138,000
Directors remuneration		13,800
Penalties for contravention of banking regulation		1,500
Audit fees		3,600
Office rent, rate and electricity		21,000
Stationery, postage and telephone		10,500
Repair and maintenance		16,800
Legal expenses:		
Loan recovery	2,700	
Fines for late filing of tax returns	600	
Acquisition of landed property	900	
Stamp duty on increase in share capital	150	4,350
Luncheon vouchers		9,750
Donations:		
National library	300	
Apapa social club	180	
Sponsorship of Calabar carnival	6,000	
University of Benin Teaching Hospital	120	6,600

(ii) Capital allowance and balancing charge for the year ended 31 December, 2019 amounted to ₦37.8million and ₦4.2million respectively.

(iii) All loans granted by the bank for agricultural trade or business had no moratorium or grace period.

(iv) Schedule of interest on loans for manufactured goods for exports are:

Repayment period including moratorium	Grace period	Amount of Interest ₦000
Above 7years	Not less than 2years	5,400
5 - 7years	Not less than 1½years	1,950
2 - 4years	Not less than 1year	1,650
Below 2years	Nil	3,000
		12,000

Required:

Compute the tax liability of the bank for the relevant year of assessment. (15 Marks)

SOLUTION TO QUESTION 6
New Era Bank Plc
Computation of Tax Liabilities for 2020 Year of Assessment

	₦'000	₦'000
Net profit as per profit or loss account		92,850
Add disallowable expenses:		
Depreciation	20,400	
General provision for loan losses	12,300	
Penalties for contravention of banking regulation	1,500	
Fines for late filing of tax returns	600	
Acquisition of landed property	900	
Stamp duty on increase in share capital	150	
Donation to Apapa Social Club	180	
Sponsorship of Calabar carnival	6,000	42,030
		134,880
Less non-taxable income		
Profit on sale of fixed assets	450	
Interest on loans for export (W1)	4,725	5,175
		129,705
Information technology levy (W2)		919
Assessable profit		128,786
Add balancing charge		4,200
		132,986
Less capital allowance		(37,800)
Total profits		95,186
Tax liabilities:		
Income tax (30% x ₦95,186)		2,855.80
Tertiary education tax (2% x ₦128,786)		2,575.72
Information technology development levy	919	919

Workings
(W1) Interest on loans for manufacturing goods for export

Repayment Period Including moratorium	Grace Period	Amount of Interest	Rate of Tax Exemption	Amount of Interest Exempted
		₦000	%	₦000
Above 7 years	Not less than 2 years	5,400	70	3,780
5 - 7 years	Not less than $1^1/_2$ years	1,950	40	780
2 - 4 years	Not less than 1year	1,650	10	165
Below 2 years	Nil	3,000	Nil	Nil
				4,725

(W2) Calculation of national information technology development levy

	₦000
Net profit before tax as stated in the audited accounts	92,850
NITDL = $\frac{1}{100 + 1} \times \underline{92,850}$ =	919.31

EXAMINER'S REPORT

The question tests the computation of tax liability of a bank.

Candidates performance was good as about 90% of them attempted the question and about 50% scored above 50% of the marks allocated.

The commonest pitfall was that few candidates did not understand the requirements of the question.

Candidates are advised to read wide towards future examinations.

7. Foremost Company Limited has been in the business of importing cement for a number of years. Following the federal government's threat to ban the importation of cement into the country, the company decided to go into the production of cement. The Managing Director of the company had read in the newspaper about the pioneer status granted to the manufacturers of cement but did not fully appreciate the significance of pioneer status and has, therefore, approached you as a tax consultant for clarification.

The company finally applied for and was granted a pioneer certificate effective from 1 July, 2013 (which coincided with the certified date of production). The pioneer status was not extended after three years of operation. The four years of operation of the company had the following results:

Accounting Year Ended 30th June

	2014	**2015**	**2016**	**2017**
	₦'000	**₦'000**	**₦'000**	**₦'000**
(a) Net profit	15,000	13,000	12,000	16,000
(b) Deductions charged before net profit:				
Depreciation	1,350	1,650	1,400	1,300
Directors fees	500			
Administration expenses	2,000	2,500	2,200	2,400
Distribution expenses	3,000	4,000	4,500	3,500
Loss on disposal of assets		680		
Donations to:				
Ikoyi Social Club	200	180	160	240
Federal University of Technology, Owerri	150	150	150	150
Audit fees	340	680	690	1,250
Legal expenses	500	600	540	820

Note that the sum of ₦300,000 was allowed by the FIRS as a reasonable charge for directors' fees for the accounting period ended 30 June, 2014.

Required:

(a) State two (2) benefits which a company can enjoy as a result of being granted a pioneer status. (2 Marks)

(b) What is the accounting period of a pioneer company? (2 Marks)

(c) Under what condition may the shareholders of a pioneer company be subject to tax on the dividend received from the company during the tax relief period? (2 Marks)

(d) If a pioneer certificate earlier issued to a company is cancelled, what is the effective date of cancellation of the pioneer certificate? (2 Marks)

(e) Compute the assessable profits of Foremost Company Limited for the relevant years of assessment. (7 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) Benefits of pioneer status

The following reliefs are available to a company granted a pioneer status:

(i) The company's profits from pioneer enterprises are exempted from companies income tax for an initial period of three years but the tax relief period could be extended for a further two years;

(ii) Dividends paid out of the exempted profits of a pioneer company are not liable to tax in the hands of the recipient shareholders;

(iii) The net loss incurred during the pioneer period is deemed to have been incurred on the day following the end of the pioneer period and is available for relief in computing the total profits of the new trade or business of the company after the pioneer period; and

(iv) The qualifying capital expenditure incurred during the pioneer period is deemed to have been incurred on the day following the end of the pioneer period and are eligible for capital allowances in the new trade or business of the company after the pioneer period.

(b) Accounting period

In relation to a pioneer company, accounting period means:

(i) a period not exceeding one year commencing on its production day;

(ii) successive periods of one year thereafter; and

(iii) a period not exceeding one year ending at the date when its tax relief period ends.

(c) Tax on dividend received from a pioneer company

Where a pioneer company distributes dividend or bonus to its shareholders in excess of the credit balance in the account maintained for exempted profits as at the date of such distribution, such excess dividend is subject to tax in the hands of the recipients (shareholders).

A pioneer company is required to maintain an account (often called section 17 account) which is to be credited with amount of profits of the company exempted from tax. Any dividends paid out of the exempted profits is not subject to tax in the hands of the recipient shareholders. Where the dividend paid is in excess of the exempted profits credited to the account, the excess dividend would be liable to tax in the hands of the recipient shareholders.

(d) Effective date of cancellation of the pioneer certificate

The effective date of cancellation of a pioneer certificate of a company shall be:

(i) the pioneer date if the pioneer company has been in operation for less than one year after the pioneer date; and

(ii) the date of the last anniversary of the pioneer date if the pioneer company has been in operation for not less than one year after the pioneer date.

The pioneer date is the date from which a pioneer certificate takes effect.

(e) Foremost Company Limited

Computation of Adjusted Profits

	Accounting Year Ended 30th June			
	2014	2015	2016	2017
	₦'000	₦'000	₦'000	₦'000
Net profit	15,000	13,000	12,000	16,000
Add disallowable deductions:				
Depreciation	1,350	1,650	1,400	1,300
Directors' fees (500 – 300)	200			
Loss on disposal of assets		680		
Donations to Ikoyi Social Club	200	180	160	240
Adjusted profits	16,750	15,510	13,560	17,540

Computation of Assessable Profits of Pioneer Business

The company would prepare its accounts of the pioneer enterprise to cover the following periods:

		Assessable profits
		₦'000
1st Year	1/7/13 - 30/6/14	16,750
2nd Year	1/7/14 - 30/6/15	15,510
3rd Year	1/7/15 - 30/6/16	13,560
		45,820

The company is not liable to tax in the first, second and third years of assessment because of the pioneer status (tax relief period of 3 years) granted to the company. The aggregate profits of ₦45,820,000 made during the tax relief period are exempted from tax.

Computation of Assessable Profits of New Business

Year of Assessment	Basis Period	Assessable Profits
		₦'000
2016	1/7/16 - 31/12/16 (6/12 x 17,540)	8,770
2017	1/7/16 - 30/6/17	17,540
2018	1/7/16 - 30/6/17	17,540

The company is liable to tax on its assessable profits after the end of the pioneer period. Hence, the company has to pay tax in 2016, 2017 and 2018 years of assessment.

EXAMINER'S REPORT

The question tests the benefits of a company that is granted a pioneer status; the accounting period, dividends policy, cancellation of certificate and computation of assessable profits.

Candidates' performance was poor. About 90% of the candidates attempted the question but more than 50% of those that attempted the question scored below average.

Candidates' did not understand the requirements of the question hence the poor performance.

Candidates are advised to avail themselves with the Institute's Pathfinders and Study Pack when preparing for future examination. They are also advised to always read wide to cover the syllabus.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2021: PROFESSIONAL EXAMINATION

PTE II: TAX AUDIT AND INVESTIGATION

TUESDAY 13TH APRIL, 2021 **EXAM NO................................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

SHOW ALL WORKINGS. **TIME: 3 HOURS.**

1. You are a Senior Inspector of Taxes, working at the Ikeja Regional Office, Tax Audit Section of the Federal Inland Revenue Service. Your work involves leading a team of tax auditors to carry out audit assignment delegated to your team by the Director of Tax Audit and Investigation. On receipt of instruction to carry out audit of a taxpayer, the first thing is to call for the file of such taxpayer to enable you and your team familiarise yourselves with the tax history of the taxpayer.

Your team has just been instructed to carry out a routine tax audit of Bonjour mon ami Nigeria Limited, a company engaged in the manufacturing and distribution of plastic products based in Ikeja Industrial Estate.

Your initial review shows that, like every other plastic company, Bonjour mon ami imports 30% of its raw materials from Germany, while the balance is sourced locally, mostly from plastic recycling plants.

From the company's file in the office, you have extracted the following:

Extracts from the previous year (2018) financial statements:

Statement of Financial Position

		₦'000
Property, plant and equipment		63,700
Receivables:	Trade	4,300
	Other	400
Inventory:	Raw materials	1,740
	Work in progress	900
	Finished goods	3,220
Payables:	Trade	2,940
	Other	900

Extracts from previous year (2018)

Income Statement

	₦'000
Revenue	81,500
Cost of sales	58,880
	23,420
Depreciation and loss on sale of non-current assets	(4,020)
Other expenses	(4,560)
Profit before taxation	14,840

Extracts from the company's 2019 financial statements:

Statement of financial position

		₦'000
Property, plant and equipment		65,120
Receivables:	Trade	7,200
	Other	500
Inventory:	Raw materials	2,400
	Work in progress	700
	Finished goods	3,720
Payables:	Trade	4,120
	Other	1,000

Extract from 2019

Income Statement

	₦000
Revenue	86,300
Cost of sales	58,360
	27,940
Depreciation and loss on sale of non-current assets	(6,900)
Other expenses	(4,680)
Profit before taxation	16,360

Required:

(a) Prepare a plan for the audit, state the procedures you will follow and what will be covered in your plan. (15 Marks)

(b) Prepare an analytical review of the extracts of 2018 and 2019 financial statements, using ratios that will help you in determining areas that may result in reduced tax liability that the audit team may need to focus on during the audit. (10 Marks)

(c) State the procedures you will follow on imported raw materials of the company and what you will look out for. (8 Marks)

(d) How will you verify that the company has complied with the provisions of the laws on withholding tax? (7 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) As the team leader, my first assignment is to plan the audit and prepare an audit planning memorandum. The following steps with be taken:

(1) The following basic information will be extracted from the taxpayer's file:
- (i) Name of the company;
- (ii) Registered address;
- (iii) Business address;
- (iv) Date of incorporation;
- (v) Date of commencement of business;
- (vi) Tax file number;
- (vii) Nature of business;
- (viii) External auditors/tax consultants and their addresses;
- (ix) Bankers/addresses;
- (x) Solicitors and secretaries;
- (xi) Share capital (authorised and issued);
- (xii) Shareholding structure;
- (xiii) Names of directors/number of shares held;
- (xiv) Associated companies/addresses;
- (xv) Litigation details, if any;
- (xvi) Period covered during the last audit or investigation exercise; and
- (xvii) Accounting year end.

(b) An analytical review of the company's tax returns will then be prepared using the following records to determine the taxpayer's performance and areas of risks the tax audit will focus:

(i) Last audit or investigation report (if any).

(ii) Financial statements:
- Chairman/directors/auditors' reports;
- Statement of financial position and statement of comprehensive income;
- Cash flow statements; and
- Notes to the accounts.

(iii) Tax Returns

From the above, a spreadsheet of statement of financial position, profit or loss statement and notes to the financial statements of the year will be prepared.

(2) Relevant accounting ratios would be computed and interpreted and areas of unusual ratios will be noted to guide the audit team's work.

(3) Audit team members will then be allocated to carry out specific areas for them to audit during the field work.

(4) The time to be spent on the audit will be estimated.

(5) All the information so far gathered will be put together in a tax audit planning memorandum. The memorandum should contain the following information:
- Background information on the taxpayer
- Taxpayer Identification Number (TIN)
- Type of audit
- Taxpayers history of tax compliance
- The audit team – Name and ranks

- Approach to the audit and areas of special focus. In particular, note major issues so far identified and how they would be addressed.
- Synopsis of information and records to be requested from taxpayers, his bankers and other third parties. This should also include a list of all schedules required for the audit.
- List of places to be visited, who to interview and arrangements being made in this regard.
- List of applicable taxes and the year involved.
- List of items to be provided by the tax payer.

(6) The tax audit memorandum will be submitted to the head of audit department for review and approval.

(b) The following ratios will be calculated:
Gross margin:
2017 = 23,420/81,500% = 28.7%
2018 = 27,940/86,300% = 32.4%

Net profit margin:
2017 = 14,840/81,500% = 18.2%
2018 = 16,360/86,300 = 19.0%

Inventory turnover:
2017 = 5,860/58,080 x 365 = 37 days
2018 = 6,820/58,360 x 365 = 43 days

Trade receivable days:
2017 = 4,300/81,500 x 365 = 19 days
2018 = 7,200/86,300 x 365 = 43 days

Trade payable days:
2017 = 2,940/58,080 x 365 = 18 days
2018 = 4,120/58,360 x 365 = 26 days

(c) Tax audit procedures on imported goods
(i) Ask for and collect the following documents:
- The bill of entry file for all imports in the year;
- The treasury receipt issued by the Nigerian Customs Service; together with the bank payment tellers;
- The approved "Form M" used in importing the goods, this will give the rate of exchange used; and
- The attested invoice issued by the manufacturer or the supplier or exporter of the goods as the case may be – the commercial invoice.
- There are some companies that maintain separate files for all import, if that is the case, ask for all the files for imports during the year. The file will contain documents in respect of each import, therefore, check that the following are complete for each import;
- The approved Form M together with proforma invoice, duly signed by the bank;

- The good in transit insurance certificate for the goods covered by the Form M;
- The Customs Bill of Entry for the import, showing duty, surcharge and VAT payable on the goods;
- The bank tellers for the payment of the amount payable to the Customs together with the treasury receipt issued by the Customs;
- The attested invoice or commercial invoice, issued by the overseas' supplier of the goods;

(ii) Summarise the imports during the year on the basis of the following:
- The cost, and freight based on the amount on the commercial invoice multiplied by the exchange rate on the approved Form M;
- The customs duty paid on the goods;
- The goods in transit insurance premium paid for the goods;
- Port charges on the goods;
- Clearance charges and transport expenses for bringing the goods into the company's warehouse; and
- Total of all the above, which represents the total cost of all imported goods during the year.
- Vouch the above with the import ledger maintained by the taxpayer and trace each import to the taxpayer's inventory records and note any discrepancy;
- Discuss the discrepancy with the taxpayer's management;
- Trace each import into the purchases used in determining cost of sales or cost of manufactured goods during year.

(d) To verify that the company has complied with the provisions of the withholding tax laws, the following procedures will be followed:
- Collect all the organisation's payment vouchers (both cash and cheque payment vouchers) month by month for the year;
- Arrange the vouchers serially or according to date order;
- Ensure that the vouchers are complete, either by seriality or according to date order;
- Ensure that attachments to the vouchers have not been detached from the vouchers;
- Collect the revenue receipts for all withholding taxes remitted by the organization to the Federal Inland Revenue Service during the year;
- Collect the following from the organisation;
- List of suppliers, contractors, consultants, etc;
- List of directors and their tax clearance; and
- Rent schedule including rent agreements.
- Vouch the payment vouchers one by one to identify withholding tax payable by the organisation to incorporated companies, government agencies and parastatals;
- List the withholding tax payable under the following categories;
- Contract and supplies;
- Professional fees;
- Commissions;
- Directors' fees;
- Dividends; and
- Rent and lease rentals;
- The summary of each of the categories of withholding tax above should contain;
- The date of the invoice/bill;

- Name of the contractor/supplier/service provider;
- Description of the contract/supply/service;
- Gross amount on the invoice/bill;
- Rate of withholding tax payable; and
- Amount of withholding tax payable
- Summarise and determine the total withholding taxes payable under each category and in total;
- Summarise the total withholding tax remitted by the organisation based on the withholding tax receipts collected;
- Compare the total withholding tax you have calculated with the total withholding tax remitted by the organisation. The difference represents outstanding withholding tax liability or unremitted/under deducted withholding tax during the year.
  However, where the total withholding tax payable, based on the above is not satisfactory, considering the volume of transactions of the company, or the organisation refused to give the auditor all payment vouchers, the tax auditor will follow the following procedures:
- Collect all receipts for withholding tax remittances to all the state internal revenue services and the Federal Inland Revenue Service;
- Summarise the receipts to determine the total withholding tax remitted, both to the states and FIRS;
- Determine the value of all purchases of goods and services during the year by:
  - Add wages and salaries together with depreciation, dividends, interest and profit before tax for the year;
  - Deduct the total you get above from the Revenue (Sales) for the year;
  - The difference represents the value of goods and services bought by the company during the year;
  - Apply withholding tax rate of 10% to determine the withholding tax payable;
  - Deduct the total remittances of withholding tax during the year, as calculated earlier;
  - The balance represents outstanding withholding tax liability for the year.

EXAMINER'S REPORT

The question tests issues on the preparation of a plan for the audit; an analytical review of financial statements by using ratios and compliance with the provisions of the laws on withholding tax. A compulsory question attempted by over 95% of the candidates.

About 20% scored above 40% of marks obtainable.

Candidates demonstrated lack of understanding of procedures to be followed on imported raw materials and how to verify compliance with provision of withholding tax laws.

Candidates are advised to prepare well for future examinations. They should make adequate use of the Institute's study pack and previous examination's pathfinders.

2. You are the tax consultant of Tom & Jerry Nigeria Limited. The company's chief accountant has just informed you that he has received a letter from one of the State's Internal Revenue Service for a tax audit.

Required:
Discuss your role as the company's tax consultant, before, during and after the audit.
(15 Marks)

SOLUTION TO QUESTION 2
Usually, when the company receives a letter from the State Internal Revenue Service intimating the company of its intention to carry out a tax audit or investigation exercise in the company, the company will send the letter to its tax consultant. The roles of the tax consultant are:

(a) Before the tax audit

On receipt of the letter, the tax consultants will carry out the following activities:

(1) The tax consultants will visit the company, discuss with the management and agree on the date the company would be ready for the audit;

(2) The tax consultants will get in touch immediately with the team coming for the audit, always listed on the letter of audit, to discuss and agree the date for the audit;

(3) If need be, the tax consultant will write a letter to the revenue service seeking for an extension of time, if the company has a genuine reason why the audit could not take place within the time stipulated on the letter of audit;

(4) The tax consultant and his staff will visit the company before the date agreed with the tax auditor to:
- Carry out a tax audit of the company's books and generate the outstanding liability, based on the audit;
- Discuss the liability with the company's management; and
- Arrange the documents required for the audit, a list of this is usually attached to the letter of audit.

(b) During the audit

(1) On the first day of the audit, the tax consultants, with his staff, will arrive earlier, before the tax audit team, at the company to:
- Secure and arrange the place the audit will take place;
- Arrange all the documents required for the audit;
- Receive the audit team on arrival;
- Arrange a pre-audit meeting with the company's management, himself and the audit team; and
- Arrange for all other things for smooth audit e.g. logistics.

(2) The tax consultants or his staff must be on ground throughout the duration of the audit, to answer any question from the audit team and or provide further information the audit team may ask for;

(3) On completion of the audit, the tax consultant will hold an exit meeting with the tax audit team and the company's management, where further clarifications could be sought by the audit team from the management regarding their findings, to clear any doubt that may arise;

(c) After the audit

(1) On receipt of the notice of additional tax liability, based on the audit, from the State Internal Revenue Service, the company will send this to the tax consultant for advise;

(2) If the liability is within the expectation of the tax consultant, in the light of the pre-audit exercise he had earlier carried out, he may advise the company to pay the additional liability, which will bring the audit exercise to a close;

(3) A letter of clearance would be bought by the consultant from the SIRS;

(4) However, if the liability is more than the expectation of the tax consultant, he will write a letter of objection to the liability to the State Internal Revenue Service, within the stipulated time frame, attaching:
- His own computation of the additional liability; and
- A cheque for the undisputed liability, as computed by the tax consultant;

(5) The tax consultant will liase with the State Internal Revenue Service to fix a date for the reconciliation of the two liabilities i.e. the revenue's liability and the one computed by the tax consultant. This meeting is called, tax reconciliation committee (TARC):

(6) If the disagreement is resolved during the meeting, the tax consultant and the representative of the State Revenue Service will sign the agreement, which will form a basis of revised liability from the Revenue Service to the company;

(7) On receipt of the notice of revised liability, the consultant will advise the company to pay the balance liability i.e., the difference between the new liability and the one paid with the notice of objection. This will bring the audit exercise to a close and the tax consultant will liase with the State Internal Revenue Service to write a letter of clearance to the company. This letter will indicate that the company has settled its tax liability to the state up to the date the audit covered;

(8) If the company and the tax consultants are still not in agreement with the revised liability, the tax consultant will write a new letter of objection to the State Revenue Service, enclosing additional evidence to help the Revenue Service to revise the liability;

(9) There will be another TARC meeting to resolve the dispute and for the Revenue Service to revise the liability;

(10) If the disagreement could not be resolved, either party can refer the dispute to the Tax Appeal Tribunal for adjudication;

(11) If the company is still not satisfied with the ruling of the Tax Appeal Tribunal, the case will be referred to the Federal High Court for settlement;

(12) If the company or Revenue Service is not satisfied with the ruling of the Federal High Court, the party will appeal to the Court of Appeal; and

(13) If either party is still not satisfied with the decision of the Court of Appeal, the party could appeal to the Supreme Court. The decision of the Supreme Court is final on the dispute.

EXAMINER'S REPORT

The question tests issues on role of tax consultant before, during and after tax audit. About 90% of the candidates attempted the question, and about 50% of them scored above 40% of marks obtainable.

Commonest pitfalls in answering the question was the inability of the candidates to discuss the tax consultant's role in the audit.

Candidates should endeavor to prepare well for future examinations. They should also make use of the Institute's Study Pack and previous examination Pathfinders.

3. Discuss the tax audit procedures a tax auditor will follow when carrying out Pay As You Earn (PAYE) audit. (15 Marks)

SOLUTION TO QUESTION 3

The tax audit procedures for PAYE audit are:

- Collect the organisation's nominal roll (list of staff) with the payroll for the year;
- Collect evidence of payment of salaries to staff, such as, letter of authority to the bank to credit the accounts of the staff for their salaries, for the whole year;
- Select some employees from the nominal roll and request for their letter of employment or letter of salary increase (especially the expatriates staff);
- For employees stated in the payroll to have spent less than 12 months in a year request for their employment or resignation/termination letter.
- Request for the company's bank statement and trace payment of salary debited to the accounts.
- Compare the above with the net pay on the payroll for selected staff so as to ensure this agrees with the payrolls;
- Summarise the total salaries month by month for the year;
- Compare the summary above with the payroll journal monthly;
- Compare the total wages and salaries, as summarized above with the organisation's trial balance and financial statements and note any difference;
- The difference, as calculated above should represents off payroll payment of allowances/salaries to staff;
- Vouch the organisation's payment vouchers, both cash and cheque payment vouchers (100% of the population) to identify and list out the following:
    - Rent and or payment in lieu of accommodation;
    - Leave/vacation allowances;
    - Medical allowances;
    - Dressing allowances;
    - Telephone allowances;
    - Lunch allowances; etc
- Summarise the individual total salaries for the year, either paid through the payroll or through payment vouchers;
- Ask for the company rent schedule and the occupier of each house to enable you determine benefit in kind on accommodation;
- Ask for schedule of motor vehicles and the name and designation of users to enable you calculate benefit in kind on the use of vehicles;
- Verify pension deductions and their remittance to the appropriate Pension Fund Administrators. Determine total pension deducted from each staff salary;
- Reconcile the total salaries and wages paid to all staff, based on your calculation, with the total personnel emolument on the financial statements and note the difference;
- The difference, as calculated above, will be used to increase each staff's total salaries based on the ratio of their basic pay;
- Calculate the tax payable by each staff and for the whole staff, using an excel tax calculation template;
- Summarise the Internal Revenue receipts for remittances by the organization during the year;

- Deduct the total remittances, summarized above, from the total tax payable calculated above. The difference represents the organisation's outstanding paye liability unremitted /under deducted tax:

EXAMINER'S REPORT

The question tests the candidates' understanding of tax audit procedures for Pay As You Earn (PAYE) audit. Less than 40% of the candidates attempted the question and well over 60% of them scored below 40% of the marks allocated. The commonest pitfall was the inability of most candidates to differentiate between general audit procedures and "Specific" PAYE Audit Procedure.

Candidates are advised to prepare well for their future examination and make use of the Institute's Study Pack and previous examination's Pathfinders.

4. The tax authorities have been given adequate power by the various tax laws so as to be able to collect all revenue due into the government covers.

Required:

(a) Discuss the powers available to tax authorities to recover outstanding tax liabilities. (10 Marks)

(b) List the contents of the form of Warrant of distraint. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) The powers of tax authorities to recover outstanding tax liability are:

(i) Power of distraint

Distraint means a process whereby force is applied to collect the tax due by seizing the movable properties of the debtor taxpayer and sealing the office premises thus forcing him/her to pay the owed tax. Also distraint is a legal process which allows the Tax Authority to seize a taxpayer's possessions and, if necessary, sell them to settle a debt owed to the Inland Revenue.

Also distraint is an effective method of enforcement which is usually carried out where all administrative procedures have failed.

The provision of power of distraint are contained in the:

- Federal Inland Revenue Establishment Act, LFN 2007, section 33 and the fourth schedule;
- Companies Income Tax Act Cap LFN 2007, section 86, subsections 1 to 2 and the fourth schedule;
- Personal Income Tax Act LFN 2007 as amended by the Amendment Act 2011, section 104; and
- Casino Taxation Act Cap C3, section 16.

(ii) Power to prosecute tax defaulters for recovery of tax

Tax may be sued for and recovered in a court of competent jurisdiction with full cost of action from the taxpayer as a debt due to the government. Section 87 (2) Companies Income Tax Act provides that a court of competent jurisdiction provided that the amount claimed in any action does not exceed the amount of the jurisdiction of the magistrate concerned with respect to action for debt.

However, The Federal Inland Revenue Service (Establishment) Act, 2007 establishes the Tax Appeal Tribunal under section 50 to settle disputes from the operations of the Act as well as the administration of the legislations listed in the First Schedule to the Act. The Tribunal has power to adjudicate on disputes and controversies arising from the following legislation:

(a) The Companies Income Tax Act;
(b) Personal Income Tax Act;
(c) Petroleum Profits Tax Act;
(d) Capital Gains Tax Act;
(e) Stamp Duties Tax Act;
(f) Value Added Tax Act; and
(g) Any other law contained in or specified in the schedule to this Act or other laws made or to be made from time to by the National Assembly.

Either the Tax Authorities or the taxpayers may appeal to the tribunal. The tax authority can appeal to the tribunal for the non-compliance of the taxpayer with the provisions of the tax laws, while the taxpayer can appeal on the assessment, demand notice or any action made against him by the tax authority with respect to payment of tax.

(b) The contents of the form of Warrant of distraint are:
(i) The name of the officer of the Revenue Board who is authorized to execute the warrant of distress;
(ii) Name of the company/taxpayer and place of business;
(iii) Amount of tax to be levied by distress;
(iv) Details about arrears of tax due for the relevant assessment years;
(v) Year of assessment;
(vi) Amount of tax due;
(vii) Signature of Executive Chairman of FIRS/SIRS;
(viii) Date of signing; and
(ix) Amount of tax outstanding against the company and which amount is to be levied by distress.

EXAMINER'S REPORT

The question tests options available to tax authorities to pursue collection of outstanding tax liabilities. About 70% of the candidates attempted the question. Less than 20% of them scored above 40% of marks obtainable. The commonest pitfall was the inability of most candidates to state other methods of collecting outstanding tax liabilities.

Candidates are advised to prepare more adequately for subsequent examination and they should make use of the Institute's Study Pack and previous examinations' Pathfinders.

5. As part of tax audit planning process, a tax auditor is required to carry out risk assessment procedures. One of the means of achieving this is taxpayer and industry profiling.

Required:
Discuss briefly the concept of taxpayer's and industry profiling in tax audit. (15 Marks)

SOLUTION TO QUESTION 5

Taxpayer and industry profiling are risk assessment technique 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 behavior 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:
- The return was filed by due date;
- Required schedules were completed;
- Taxes were overdue; and
- Financial statements have been filed with other statutory authorities.

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

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

(d) Review changes in paid-in capital and major shareholders.
(e) Review inventories movements between affiliated companies.
(f) Review of transfer pricing issues if the taxpayer is a member of multinational, which involves:
- Review transfer pricing;
- Review the flow of funds to or through tax havens;
- Examine arm's length dealings; and
- Research any advance pricing arrangements.

(g) Review the tax taxpayer, which includes examination of the taxpayer's:
- Organisation chart;
- Major products;
- Functions of each department of enterprise;
- Documentation relating to tax planning strategies
- Taxpayer's use of e-commerce

(h) Review third party information, which includes, quarterly returns from banks, returns from customs, etc.
(i) Review of the current industry environment of the taxpayer, which includes:
- The current market trend of the products;
- The position of the taxpayer in the market place; and
- The average industry indices.

The level of other pre-contact work will largely depend on the complexity of the affairs of the customer concerned, and the tax risks identified during risk assessment. However, these can be categorized into four general headings:

- Reviews of unreported income;
- Intelligence gathering;
- Review of prior compliance history; and
- Returns preparer performance, i.e. that tax consultant of the taxpayer that filed the returns.

EXAMINER'S REPORT

The question tests issues on the concept of taxpayers and industry profiling in tax audit. About 60% of the candidates attempted the question. Only about 40% of them scored above 40% of marks obtainable.

Candidates demonstrated lack of understanding of what constitute profiling in tax audit planning process.

Candidates are advised to prepare adequately for future examination and avail themselves of the Institute's Study Pack and previous examinations' Pathfinders.

6. As a tax auditor, your objective is to gather evidence from your audit of a taxpayer's financial records. However, such evidence must be sufficient and appropriate.

   Required:

   (a) What do you understand by sufficient and appropriate audit evidence? (4 Marks)

   (b) Discuss the factors that will affect your decision on what you think is a sufficient and appropriate audit evidence. (5 Marks)

   (c) You are expected to exercise judgement on what you will consider to be a sufficient relevant and reliable audit evidence. Give six (6) factors that will influence your judgement? (6 Marks)

   (Total 15 Marks)

SOLUTION TO QUESTION 6

(a) Sufficiency and appropriateness of audit evidence are interrelated and both apply to tests of controls and substantive procedures. Sufficiency is the measure of the quantity of audit evidence while appropriateness refers to the measure of the quality or reliability of the audit evidence.

(b) Factors that may influence the sufficiency of audit evidence are:
- Materiality of the item being tested;
- Level of audit risk involved;
- Persuasiveness of the audit evidence obtained;
- Population of the item – how large the item is;
- Client's accounting and internal control system; and
- Client's financial condition

(c) The auditor's judgement will be influenced by factors such as:
- The auditor's knowledge of the business and its environment;
- The risk of misstatement the auditor has identified;
- The persuasiveness of the evidence;
- The nature of the accounting and internal control system;

- The materiality of the item being examined;
- The experience the auditor gained during previous audit;
- The results of audit procedures; and
- The source and reliability of information available.

EXAMINER'S REPORT
The question tests issues on the sufficiency and appropriate audit evidence. Less than 40% of the candidates attempted the question. The performance was very poor as only about 10% scored above 40% of marks obtainable.

Commonest pitfalls in answering the question was the inability of many candidates to understand the meaning of "Sufficient" and "Appropriate" evidence in auditing a client.

Candidates are advised to prepare well for subsequent examination. They should also make adequate use of the Institute's Study Pack and previous examinations' Pathfinders.

7. Explain the similarities and the differences in the objectives, work and report of:
   (a) An internal auditor

   (b) An external auditor

   (c) A tax auditor (15 Marks)

SOLUTION TO QUESTION 7
The similarities and distinction of the purpose and works of an internal auditor, an external auditor and a tax auditor is presented in tabular form below:

S/N	Internal Auditor	Statutory Auditor	Tax Auditor
1.	Internal auditor is an employee of the firm	Statutory auditor is an external body/firm	Tax auditor is an employee of Federal Government/FIRS/SIRS
2.	The management of the organization determines the work to be undertaken by the Internal Auditor	Statutory Auditors works according to the rules and regulations of Companies and Allied Matters Act.	Tax audit is carried out to enable the tax auditor to ascertain whether the taxpayers has complied with the provisions of the relevant tax laws.
3.	Internal auditor will examine issued related to company business practices and risks	The external auditor examines the financial records and produce a report expressing his opinion on the truth and fairness of the financial statements.	Tax audit is to determine the correct amount of tax payable in accordance with the relevant tax laws, rule and regulations.
4.	Internal audit are carried out throughout the year	The statutory audit conduct a single annual audit. The Corporate Affairs Commission (CAC), FIRS and others require	The frequency of tax audit is determined by the management of the relevant tax authority.

		companies to submit their audited financial statements to them on a yearly basis.	
5.	Internal auditors are hired by the company	The statutory auditors are appointed by the shareholders	Tax auditors are employees of the relevant tax authority
6.	Internal auditors does not necessarily have to be qualified chartered accountants.	The statutory auditors must be qualified chartered accountant and must have practicing license certificate	There is no provision in the tax laws that say a tax auditor must be a chartered accountant
7.	Internal auditors are responsible to the management of the firm	The statutory auditors are responsible to shareholders	Tax auditors are responsible to the management of relevant tax authority
8.	Internal auditors can issue their findings in any type of report format	Statutory auditors must use specific templates (formats) for their audit opinions and management letters.	Tax auditor's report must be in the format prescribed by the relevant tax authority
9.	Internal audit report are used by management	Statutory audit report is addressed to the members – shareholders of the company	Tax audit report is addressed directly to the management of the relevant tax authority.
10.	Internal auditors can provide professional advice and consulting assistance to employees and management of the firm.	Statutory auditors are legally constrained from engaging in other advisory services to this client	The tax auditor can be assigned any other duty by the relevant tax authority.
11.	An effective system of internal checks to prevent or detect errors and fraud and necessary corrections are put in place	To examine the internal controls and to ascertain that they safeguard the company assets against fraud, embezzlement and theft	Tax audit is to determine the correct amount of tax payable in accordance with the relevant tax laws.
12.	The duties of an internal auditors are governed by the operational activities of the company	The duties, rights, powers etc. of the statutory auditor are governed mainly by the provisions of Companies and Allied Matters Act, Accounting Standard, Auditing guidelines, Professional regulations etc.	Tax auditors powers and authority are governed by the provisions of the relevant tax laws.

EXAMINER'S REPORT

The question test candidates' understanding of similarities and differences in the objectives, work and report of internal auditor, external auditor and a tax auditor.

About 80% of the candidates attempted the question. And about 60% scored above 40% of total marks obtainable.

The commonest pitfall in answering the question was their inability to explain the similarities, objectives, work and report of external, internal and tax audit.

Candidates are advised to prepare well for subsequent examinations and read the Study Pack and Pathfinders very well.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2021: PROFESSIONAL EXAMINATION

PTE II: INTERNATIONAL TAXATION

TUESDAY 13TH APRIL, 2021 **EXAM NO................................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

TIME: 3 HOURS.

1. Swagger Inc. is tax resident in Swag, a country known for innovative IT products. The company's world-wide income for 2019 year of assessment was assessed to tax in Swag.

   Little Swagger Ltd, a 100% subsidiary of Swagger Inc., is tax resident in Little where it undertakes software development activities on behalf of the group, and also runs call centres.

   Officials of Little Revenue Service (LRS) agreed that the dealings between Swagger Inc. and Little Swagger Ltd were at arm's length and that Swagger Inc. did not directly execute any contract in Little.

   After a tax audit exercise, the LRS established the following facts concerning the Swagger Group's activities in Little:

   (i) 40% of the group's employees were based in Little;

   (ii) All of the group's call centres and software development centres were situated in Little;

   (iii) Swagger Inc. was essentially performing only marketing functions while its contracts with clients in Little were assigned or sub-contracted to Little Swagger Ltd;

   (iv) Under the service agreement between Little Swagger Ltd and Swagger Inc., complete control of Little Swagger's personnel rests with Swagger Inc; and

   (v) Little Swagger Ltd carried out its functions for the group using only the proprietary database and software of Little Swagger Inc. The software and data were provided free of cost to Swagger Ltd.

The LRS contended that some of Swagger Inc.'s profits were attributable to and taxable in Little because Swagger Inc. had a permanent establishment (PE) in Little at all material times. The LRS further argued that the income earned and taxed in the hands of Little Swagger Ltd was materially different from the income attributable to the PE of Swagger Inc. as the latter included some of Little Swagger Ltd.'s tax base.
You have been nominated to analyse the case in a public discuss within the context of article 5 of the UN Model Tax Convention.

You are to particularly address the following issues:

(a) The possibility of Swagger Inc. having a permanent establishment (PE) in Little under each type of PE available in the UN Model Tax Convention. (30 Marks)

(b) Whether or not Swagger Inc. (a non-resident company) can still be liable to tax in Little considering that the worldwide income of its subsidiary (Little Swagger Ltd) is wholly taxable in that county. (10 Marks)
(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) The possibility of Swagger Inc. having a permanent establishment (PE) in Little under each type of PE available in the UN Model Tax Convention.

The types of Permanent Establishment (PE) available under the UN Model Tax convention are fixed place, construction site, service and dependent agency. The applicability of each form of the circumstance of Swagger Inc. is discussed below:

Fixed Place PE
The basic concept of PE is essentially a fixed place PE as can be seen in the definition of a PE that is a fixed place of business through which the business of an enterprise is wholly or partly carried on.

The most common type of PE is the fixed place PE considering that business operations still depend largely on physical presence. As such, a fixed place PE include following:

(i) A place of management;
(ii) A branch;
(iii) An office;
(iv) A factory;
(v) A workshop;
(vi) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
(vii) Farm or forest; and
(viii) Long-term building site.

In order to establish the existence of a fixed place PE, the main tests are:

(i) Existence of a fixed place, that is, a specific geographical location in a jurisdiction;
(ii) The place is at the disposal of the foreign enterprise; and

(iii) The business of the foreign enterprise is carried on wholly or partly at the location.

The is no direct information that Swagger Inc. had physical presence in Little. However, existence of contracts which were either assigned or sub-contracted to Little Swagger Ltd. raises the question as to how Swagger Inc. solicited for, negotiated and signed those contracts. If its personnel did this directly, it might be possible to argue that there was fixed place PE.

Secondly, all software development activities and call centres were located in Little. If these facilities were placed at the disposal of Swagger Inc. for the purposes of its marketing operations, then it may be implied that the company had taxable presence in Little.

Construction Site or Project PE
A building site, a construction, assembly or installation project or supervisory activities in connection therewith will constitute a PE provided relevant conditions of time threshold are met.

The business operations of the Swagger Group did not include construction, as such this is not applicable in its case.

Service PE
According to the UN MTC, the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, shall constitute a PE for the foreign company if relevant time threshold is met.

Swagger Inc. had contracts with local clients which were subcontracted to Little Swagger Ltd. The foreign company is the service provider notwithstanding that it subcontracted the work to its subsidiary. There is the possibility that the employees of Little Swagger Ltd might constitute a service PE for Swagger Inc. by carrying out the services on its behalf.

Note that in relation to who provides the service, it might not be necessary for employees of Swagger Inc. to have been physically involved in rendering the service.

Dependent Agency PE
The UN MTC in article 5(5) provides that where a person is acting in a Contracting State on behalf of an enterprise, that enterprise shall be deemed to have a permanent establishment in that state in respect of any activities which that person undertakes for the enterprise. The situation is referred to as dependent agency PE (DAPE).

Swagger Inc. won some contracts in Little which were either assigned or sub-contracted to Little Swagger Ltd. In the case where some other persons negotiated the contracts on its behalf, those persons may create a dependent agency PE for Swagger Inc.

(b) Whether Swagger Inc. (a non-resident company) can still be liable to tax in Little considering that the worldwide income of its subsidiary (Little Swagger Ltd) is wholly taxable in that county.

A non-resident company can be taxed in the country where it has a subsidiary on the profits attributable to the PE formed by the company. The fact is that the subsidiary (in this case Little Swagger Ltd) is being taxed in Little.

The subsidiary is an independent and a distinct entity which is taxable on its income. The foreign entity (Swagger Inc.) is equally taxable on the profits that are attributable to its PE in the country, notwithstanding that the subsidiary is situated therein.

The income of the subsidiary is not taxable in the hands of the non-resident principal and vice-versa. Thus, there is no double taxation. In any case, the above stated principle requires that a PE be found to exist.

EXAMINER'S REPORT

The question tests candidates' knowledge of the basic rules of permanent establishment and a situation when a non-existent company can be taxed in a country where it has a subsidiary.

Candidates' performance was poor as most of them that attempted the question scored less than 20% of the allocated marks.

Most of the candidates displayed poor knowledge of the basic rules of permanent establishment.

Candidates are advised to read the Institute's Pathfinders, Study Packs and other relevant texts in their preparations for the Institute's examinations.

2. (a) From an international tax perspective, explain "nexus". (5 Marks)

(b) How would you determine the "nexus" status of a company or an individual? (10 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) From an international tax perspective, explain "nexus".

"Tax Nexus" or "genuine link" refers to the existence of sufficient connection between a taxing state and a person, property or transaction for that state to exercise its taxing rights.

Nexus describes whether for a given transaction, the taxpayer, property or activity has a sufficient connection with the taxing state for it to come within that state's tax jurisdiction.

Now that the world economy has become extremely digitalised, tax nexus, essentially, depends on physical presence for persons, property or transaction.

Generally, nexus can be classified into two namely: personal nexus (e.g. residence) and a territorial nexus (e.g. source). This principle is applicable to individual and corporate taxpayers.

(b) How would you determine the "nexus" status of a company or an individual?

The nexus status of a company is determined thus:

(i) Ascertain the place of incorporation – generally, a company is deemed to have tax nexus in the country in which it was incorporated. Such companies are deemed ordinarily resident in that country and the country would exercise taxing right over its worldwide income;

(ii) Ascertain the place of effective management – the place of effective management of a company refers to that place where critical or strategic decisions concerning the existence and operations of the company are taken. Having the place of effective management of a company in a country may give that country the taxing right over its income depending on the tax laws of the country; and

(iii) Ascertain the place of principal activity – the place of principal activity is where the main business of the company is carried out. In the case of a foreign company, the place of principal activity would be the PE. The country in which the place of principal activity is sighted would ordinarily claim taxing right over the profits attributed to that activity carried on in the country.

The nexus status of an individual is determined thus:

(i) Ascertain the location of the person's permanent home or abode; and
(ii) Ascertain if the individual was present in the jurisdiction for the minimum time threshold prescribed by the relevant tax law.

EXAMINER'S REPORT

The question tests candidates' knowledge of "tax nexus" with emphasis on the determination of the nexus status of a company or an individual.

Candidates' performance was poor as most of them that attempted the question scored less than 40% of the allocated marks.

Candidates' commonest pitfall was their inability to define "nexus", let alone determine the "nexus status" of a company or an individual.

Candidates are advised to make use of the Institute's Study Packs, Pathfinders and other relevant texts when preparing for future examinations.

3. A debate is currently going on in the international tax arena on the need to introduce a regime of **mandatory binding arbitration** for the purposes of achieving timely, effective and efficient tax dispute resolutions.

   (a) List Five (5) possible benefits of such dispute resolution regime. (5 Marks)

   (b) Discuss briefly Five (5) reasons why developing countries may be disadvantaged under such a regime. (10 Marks)

   (Total 15 Marks)

SOLUTION TO QUESTION 3

(a) The advantages of such tax dispute resolution regime include:

(i) Uniform and even application of tax rules;
(ii) Global tax certainty;
(iii) Timely dispute resolution;
(iv) Avoidance of double taxation;
(v) Conducive global investment environment;
(vi) Reduced cost of compliance;
(vii) Improved voluntary tax compliance; and
(viii) Improved confidence in the tax system globally.

(b) Reasons why developing countries may be disadvantaged under such a regime include:
(i) Loss of tax sovereignty: developing countries may lose the ability to apply their tax rules as intended since they must accept the rulings pronounced by the international arbitrators;
(ii) Capacity: many developing countries do not have developed adequate capacity to participate in international arbitration. As such, they may not be able to effectively present or defend cases before the international arbitration;
(iii) Costs: most arbitration sittings are done outside the jurisdictions of developing countries. As such, cost of travelling to participate at the arbitration sittings may become prohibitive;
(iv) Justice or fairness: there are concerns that the rulings of an arbitration conducted outside the shores of developing countries and by persons of other lands may be skewed in favour of developing countries; and
(v) Delayed dispute resolution: International arbitration process is an additional layer to the domestic dispute resolution system.
As such, referral of tax disputes to international tax arbitration may prolong the time it takes for such disputes to be resolved.

EXAMINER'S REPORT
The question tests candidates' understanding of international tax dispute resolution mechanisms.

The candidates' performance was poor as most of them that attempted the question scored less than 30% of the allocated marks.

The commonest pitfall of the candidates was their inability to explain the reasons why developing countries may be disadvantaged under such a regime.

Candidates are advised to read widely before sitting for the Institute's examinations.

4. Explain briefly the following:

(a) Controlled Foreign Corporation (CFC) (3 Marks)

(b) Active Income (3 Marks)

(c) Passive Income (3 Marks)

(d) Tax race to the bottom (3 Marks)

(e) Fiscal evasion (3 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) Controlled Foreign Corporation or Company (CFC)

A controlled foreign corporation is any company that is resident in one country but effectively owned or controlled by persons resident in another country. Ownership or control of the company of the company is based upon the ownership and control of the company's equity.

For example, if a group of Nigeria tax residents (individuals or corporate) control the majority of the shares of a company registered and operating in Ghana, such a company is a CFC.

(b) Active Income

Active income refers to income earned by rendering a service or producing a valuable article. Active income is income earned for the amount of work done or value created. As such, exertion of physical or mental effort is required in order to generate active income.

Business profits, technical, management or professional service fees, wages, salaries, commissions, etc. are examples of active income.

(c) Passive Income

Passive income refers to regular earnings from a source other than employment or business operations. It is income generated without carrying out business, trade or vocation; in other words, there is no exertion of physical or mental effort.

Examples of passive income include dividend, interest, rent, royalty and the like.

(d) Tax Race to the Bottom

Tax race to the bottom refers to a competitive state where a company or nation attempts to undercut competitors. The race to the bottom results from cutthroat competition.

With respect to tax, it is a race among countries to entice companies to move their operation to their jurisdiction by relaxing tax rules instead of refining them. Relaxing tax rules involves lowering tax rates, granting tax holidays, etc.

A country engaged in tax competition would cut rate, grant tax holidays, relax tax compliance rules, etc. in order to attract companies. The result of such practice is loss of tax revenue that would have accrued to the country.

The bottom is reached when retaliatory rate reduction or tax waivers effectively among nations reduces tax revenue to a level where the countries involved are unable to provide relevant public goods to their citizens. As such, the countries would head downwards or fall.

(e) Fiscal Evasion

Fiscal evasion is the same as tax evasion. It is an illegal activity in which a person or entity refused, neglected or otherwise or otherwise failed to pay the true amount of tax liability. In other words, it refers to the efforts by individuals, firms, and other entities to evade the payment of taxes by illegal means.
Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability. Acts of tax evasion include dishonest tax reporting (such as under-declaring income, profits or gains; or overstating deductions), refusal or failure to pay tax due.

EXAMINER'S REPORT
The question tests candidates' knowledge of key terminologies, such as controlled foreign corporation (CFC), active and passive income, tax race to the bottom and fiscal evasion.

Candidates' performance was poor as most of them that attempted the question scored less than 40% of the allocated marks.

The commonest pitfalls of the candidates were their inability of explain "Controlled Foreign Corporation" and "Tax race to the bottom".

Candidates are advised to read all the topics in the syllabus before sitting for the Institute's examinations.

5. Within the context of corporate income tax, explain briefly the following terms and their relationships, if any:

(a) Place of incorporation (3 Marks)

(b) Place of central management (3 Marks)

(c) Place of seal (3 Marks)

(d) Place of head office (3 Marks)

(e) Place of principal activity (3 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 5

(a) Place of incorporation
The place of incorporation refers to the country where a company was incorporated. Essentially, a company is a corporate citizen of the country under whose laws it was incorporated.

The place of incorporation is one of the factors used in determining whether or not a company is liable to tax in a country, for example, a company incorporated in Nigeria is liable to tax on its worldwide income in Nigeria.

(b) Place of central management
Place of central management refers to the location (in a country) where the operations of a company or a group of companies are centrally managed and coordinated. Critical

and strategic policy or operational decisions concerning a company or group are taken at the place of central management.

The place of central management may as well be the place of effective management if all decisions pertaining to the company's existence are taken there.

Where the central management results into effective management of the company in that place, the company may become liable to tax in the country on that basis.

(c) Place of seal

The place specified on a document where a seal is located or is to be located. It is usually the corporate headquarters of the company or where the company secretariat is located.

If there is no other business activity of the company carried out at the place of seal, the place of seal may not be enough for a company to become liable to tax in the country where the place of seal is located.

(d) Place of head office

The place of head office is the country where the head office of a company is located; it is not necessarily the place of incorporation.

The head office generally controls and coordinates the activities of a company. As such, depending on the facts and circumstances, the place of head office may be the place of effective management. In the event that effective management takes place at the head office, the company may become liable to tax on its worldwide income in the country.

(e) Place of principal activity

The place of principal activity is that place where a person carries out his business, trade, vocation or profession. In order words, the place where the person generates its income.

In the case of foreign company, the place of principal activity would be its permanent establishment (PE).

The concept of place of principal activity is central to the exercise, by a source country, of jurisdiction over the income of a foreign company or non-resident individual.

EXAMINER'S REPORT

The question tests candidates' understanding of key terminologies relating to the basic rules of permanent establishments.

The candidates' performance was poor as most of them that attempted the question scored less than 40% of the allocated marks.

The commonest pitfall of the candidates was their inability to explain how each of the terminologies is used in determining whether or not a company is liable to tax in a country.
Candidates are advised to prepare adequately for the Institute's examinations to ensure good performance.

6. Discuss each of the transfer pricing methods prescribed by the Income Tax (Transfer Pricing) Regulations, 2012 and 2018, highlighting one relative strength and weakness of each method with regard to the arm's length principle. (15 Marks)

SOLUTIONT O QUESTION 6

The transfer pricing methods prescribed in the Income Tax (Transfer Pricing) Regulations 2018 are:

(a) Comparable uncontrolled price method (CUP)

The CUP method compares the price charged for property or service transferred in a controlled transaction (i.e. between associated enterprises) to the price charged for property or services transferred in a comparable uncontrolled transaction (i.e. between independent persons).

Any difference between the two prices may indicate that the conditions of the commercial and financial transactions of the associated enterprises are not at arm's length, and that the price in the uncontrolled transactions may need to be substituted for the price in the controlled transaction.

Strengths:

(i) The CUP method is relative simple to apply.

(ii) It is not affected by differences in accounting treatment or reporting of other transactions.

Weaknesses:

(i) The application of the CUP method requires a high degree of comparability of product as such, comparable may be hard to find.

(b) Resale price method (RPM)

The RPM is a method whereby by resale margin that a purchaser of a property in a controlled transaction earns from reselling the property in an uncontrolled transaction is compared to the resale margin earned in a comparable uncontrolled purchase and resale transaction.

Appropriate arm's length resale price margin is subtracted from the sale price to arrive an arm's length price for the original transfer of property between the associated enterprises. This method is probably most useful where it is applied to marketing operations.

Strengths:

(i) The RPM can be effectively applied with less product comparability if there is functional comparability.

(ii) Only the financial indicator of one of the parties to the controlled transaction (the tested party) is required for examination; as such, it can still be applied where one of the parties has complex or interrelated activities.

Weaknesses:

(i) It is difficult to apply where the reseller performs additional functions such as alteration to the product resold.

(ii) It be difficult to obtain comparable gross margin data.

(iii) Being a one-sided method, it is possible for either party to the controlled transaction to be left with an extreme or improbable profit result.

(c) Cost plus method (CPM)

The CPM is a method in which the mark up on the costs directly and indirectly incurred in the supply of goods, property or services in a controlled transaction is compared with the mark up on those costs directly or indirectly incurred in the supply of goods, property or services in a comparable uncontrolled transaction.

The cost plus method begins with the cost incurred by the supplier of property (or services) in a controlled transaction for property transferred or services provided to an associated purchaser. An appropriate mark-up that would guarantee an appropriate profit, in the light of functions performed and market condition, is then added to the cost. What is arrived at after adding the mark-up to the costs would be regarded as an arm's length price of the original controller transaction.

This method is most useful where semi-finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.

Strengths:

(i) The CPM is simple to apply.
(ii) It can be effectively applied with less product comparability provided there is functional comparability.
(iii) Only the financial indicator of one of the parties to the controlled transaction (the tested party) is required for examination; as such, it can still be applied where one of the parties has complex or interrelated activities.

Weaknesses:

(i) Difficult in obtaining comparable mark-up data.
(ii) Being a one-sided method, it is possible for either party to the controlled transaction to be left with an extreme or improbable profit result.

(d) Transactional net margin method (TNMM)

The TNMM is a method in which the net profit margin relative to the appropriate base, including costs, sales or assets that a person achieves in a controlled transaction is compared with the net profit margin relative to the same basis achieved in a comparable uncontrolled transaction.

The TNMM operates in a similar manner to the cost plus and resale price methods. A functional analysis of the controlled and uncontrolled transactions is required to determine whether the transactions are comparable and what adjustments may be necessary to obtain reliable results.

Strengths:

(i) Net profit indicators are less affected by transactional differences than is the case with price, as used by the CUP method.

(ii) Net profit indicators may be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins.

(iii) Only the financial indicator of one of the parties to the controlled transaction (the tested party) is required for examination; as such, it can still be applied where one of the parties has complex or interrelated activities.

Weaknesses:

(i) TNMM is easily influenced by some factors that would either not have an effect, or have a less substantial or direct effect, on price or gross margins between independent parties.

(ii) It requires information on uncontrolled transactions that may not be available at the time of the controlled transactions and enough specific information on profits attributable to controlled transactions including operating expenses, may not be readily available.

(iii) Net profit indicators may be affected by forces operating in the industry.

(iv) It is difficult to apply where both parties to the controlled transaction make unique and valuable contribution to the transaction.

(v) It cannot be applied in the event of highly integrated operations.

(vi) Being a one-sided method, it is possible for either party to the controlled transaction to be left with an extreme or improbable profit result.

(e) Transactional profit split method (TPSM)

TPSM is a method in which the division of profit or loss that a person achieves in a controlled transaction is compared with the division of profit or loss that would be achieved when participating in a comparable uncontrolled transaction.

The profit split method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent enterprises would have expected to realise from engaging in the transaction. It may also be a split of losses.

Strengths:

(i) A main strength is that it offers a solution for highly integrated operations for which a one-sided method would not be appropriate.

(ii) It is applicable when both parties make valuable contributions to the transaction.

(iii) With TPSM, it is less likely that either party to the controlled transaction will be left with an extreme or improbable profit result.

Weaknesses:

(i) Difficulty in accessing relevant information residing with offshore affiliates.

(ii) Determining appropriate basis for allocating operating expenses.

EXAMINER'S REPORT

The question tests candidates' knowledge of transfer pricing methods, strengths and weaknesses of each method, and arm's length principle.

Candidates' performance was poor as most of them that attempted the question scored less than $33^1/_3$% of the allocated marks.

Most of the candidates' displayed poor understanding of the strengths and weaknesses of each transfer pricing method.

Candidates' should endevour to read all the topics in the syllabus when preparing for the Institute's examinations.

7. (a) Under the Income Tax (Country-by-Country Reporting) Regulations, 2018, ultimate parent entity of a Multinational Enterprise (MNE) Group has the primary responsibility to file Country-by-Country Reports (CbCR).

Required:
Under what conditions will a constituent entity of an MNE be required to file the CbCR report instead of the ultimate parent entity? (9 Marks)

(b) Explain briefly what the tax authorities use the CbCR information for? (6 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) The conditions, under which a constituent entity of an MNE may be required to file the CbCR instead of the ultimate entity include:
- (i) Where, the ultimate parent company of the group is not obliged to submit CbCR's in its home jurisdiction;
- (ii) Where FIRS and the tax authority in the ultimate parent company's home jurisdiction have not activated the CbCR exchange relationship as at the time the disclosures are due; and
- (iii) Where the tax authority in the ultimate parent company's jurisdiction has suspended automatic exchange of CbCRs with Nigeria.

(b) (i) The Service shall only use the Country-by-Country Report for purposes of assessing high level transfer pricing risks and other base erosion and profit shifting related risks in Nigeria.

(ii) It assists tax authorities in ascertaining global allocation of income and taxes within MNEs by the calculation of certain financial ratios.

EXAMINER'S REPORT

The question tests candidates' knowledge of the Income Tax (Country – by Country Reporting) Regulations, 2018, in relation to the filing of Company – by – Company Reports (cbcRs) by constituent entities of multinational enterprises (MNEs) instead of ultimate parent entities. Candidates are expected to state the reasons why tax authorities usually expect relevant taxpayers to file these reports at the tax office.

Candidates' performance was poor as most of them that attempted the question scored less than 20% of the allocated marks.

Most of the candidates were not able to explain the conditions when a constituent entity of an MNE is required to file the CbCR instead of the ultimate parent entity. They could also not explain what tax authorities use the CbCR information for.
Candidates are advised to read the Institute's Pathfinders and Study Packs when preparing for future examinations.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2021: PROFESSIONAL EXAMINATION

PTE II: FINANCIAL AND TAX ANALYSIS

WEDNESDAY 14TH APRIL, 2021 **EXAM NO……………………………**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

SHOW ALL WORKINGS. **TIME: 3 HOURS.**

1. The five year summarized financial statements of Libra Drinks Nigeria Limited is shown below:

Income statements:

Years	**2015**	**2016**	**2017**	**2018**	**2019**
	₦'m	**₦'m**	**₦'m**	**₦'m**	**₦'m**
Revenue	489.8	583.5	665.4	716.6	797.3
Cost of sales	286.8	(332.7)	(381.5)	(400.5)	(419.6)
Gross profits	203.0	250.8	283.9	316.1	377.7
Marketing and distribution expenses	(72.7)	(94.3)	(104.6)	(108.4)	(129.5)
Administrative expenses	(22.7)	(26.6)	(30.1)	(36.7)	(38.5)
Finance expenses	(1.7)	(4.7)	(10.8)	(23.8)	(22.1)
Profit before tax	105.9	125.2	138.4	147.2	187.6
Income tax expense	(8.5)	(19.5)	(18.9)	(11.0)	(27.9)
Profit after tax	97.4	105.7	119.5	136.2	159.7

Statement of financial position

Years	**2015**	**2016**	**2017**	**2018**	**2019**
	₦'m	**₦'m**	**₦'m**	**₦'m**	**₦'m**
Assets:					
Non-current assets:					
Property, plant and equipment	275.1	310.8	329.4	337.6	345.7
Current assets:					
Inventories	49.5	43.9	49.3	54.8	54.0
Trade receivables	54.9	67.3	89.4	111.6	122.3
Prepayments	1.3	1.5	1.5	2.0	2.6
Cash and cash equivalents	5.3	19.1	33.2	18.5	64.7
Total current assets	111.0	131.8	173.4	186.9	243.6
Total assets	386.1	442.6	502.8	524.5	589.3

Equity:

Share capital	2.0	2.0	2.0	2.0	2.0
Retained earnings	113.5	139.2	162.7	194.9	244.5
Total equity	115.5	141.2	164.7	196.9	246.5
Liabilities:					
Long term loans	129.4	117.8	132.3	91.9	62.6
Employee benefit	3.6	5.4	9.1	9.2	11.9
Deferred tax liabilities	15.3	24.8	30.5	26.3	32.8
Total non-current liabilities	148.3	148.0	171.9	127.4	107.3
Current liabilities:					
Bank overdraft	--	24.7	--	6.2	1.5
Current liabilities	11.9	11.8	14.0	17.4	25.2
Short term loans	13.3	17.3	4.7	63.6	85.6
Trade payables	95.6	97.7	145.4	110.3	120.1
Provisions	1.5	1.9	2.1	2.7	3.1
Total current liabilities	122.3	153.4	166.2	200.2	235.5
Total equity and liabilities	386.1	442.6	502.8	524.5	589.3

Note:
Inventories:
Inventories comprise:

Finished goods	5.1	4.7	4.6	4.3	4.3
Raw materials:					
Concentrate	15.0	12.6	12.5	16.0	15.5
Sugar	8.0	4.2	7.1	7.7	7.5
Components:					
Plastic bottles	20.3	21.2	24.0	25.2	25.2
Covers	1.1	1.2	1.1	1.6	1.5
	49.5	43.9	49.3	54.8	54.0

Required:

(a) Discuss the steps necessary to carry out a financial statements analysis. (5 Marks)

(b) Prepare a common size analysis of Libra Drinks Nigeria Limited for 2015 to 2019. (10 Marks)

(c) What is the company's net operating cycle in 2019? (10 Marks)

(d) Show the trend analysis of the company's performance, efficiency and short and long term financial position, using ratios. (15 Marks)

Note: Your solutions should be to one decimal place.

(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) The steps necessary in carrying our financial statements analyses are:

(i) Determining the user of the analysis. This is done by asking the following questions:
- Who is the user?
- What information is the user interested in?
- Why was the user requested for this report?
- How should the information be presented to the user?

(ii) Establish some background information about the entity you are analysing its financial statements. This is done by asking the following questions:
- What industry does the company operate in?
- When is the entity's financial year end?
- Is the entity's business seasonal?
- Have there been any key transactions during the year that affect comparisons with previous years?

(iii) Carry out accounting analysis. This is done by performing a thorough review of the financial transactions and events that result in the financial statements to determine whether the figures in the financial statements reflect the economic reality of the entity. It includes the evaluation of the entity's accounting risks and earnings quality, estimating the entity's earnings power and making necessary adjustment to the financial statements to both better reflect the economic reality and make the financial statements useful for financial analysis.

(iv) Carry out your financial analysis on the adjusted financial statements.

(b) Libra Drinks Nigeria Limited common size members Libra Drinks Nigeria Limited Common size analysis 2015 – 2019

Years	**2015**	**2016**	**2017**	**2018**	**2019**
Revenue	100.0	100.0	100.0	100.0	100.0
Cost of sales	58.6	57.0	57.3	55.9	52.6
Gross profit	41.4	43.0	42.7	44.1	47.4
Marketing and distribution expenses	14.8	16.2	15.7	15.1	16.2
Administrative expenses	4.6	4.5	4.5	5.1	4.8
Finance expenses	0.3	0.8	1.6	3.3	2.8
Profit before income tax expenses	21.6	21.5	20.8	20.5	23.5
Income tax expenses	1.7	3.4	2.8	1.5	3.5
Profit after tax expenses	19.9	18.1	18.0	19.0	20.0
Statement of financial position					
Assets					
Non-current assets					
Property, plant and equipment	71.2	70.2	65.5	64.4	58.7
Current assets:					
Inventories	12.8	9.9	9.8	10.4	9.2
Trade receivables	14.2	15.2	17.8	21.3	20.7
Prepayments	0.3	0.3	0.3	0.4	0.4

Cash and cash equivalent	1.4	4.3	6.6	3.5	11.0
Total current assets	26.8	29.8	34.5	35.6	41.3
Total assets	100.0	100.0	100.0	100.0	100.
Equity:					
Share capital	0.5	0.5	0.4	0.4	0.3
Retained earnings	29.4	31.5	32.4	37.2	41.5
Total equity	29.9	32.9	32.8	37.6	41.8
Liabilities					
Non-current liabilities					
Long term loans	33.5	26.6	26.3	17.5	10.6
Employee benefit	0.9	1.2	1.8	1.7	2.0
Deferred tax liabilities	4.0	5.6	6.1	5.0	5.6
Total non-current liabilities	38.4	33.4	34.2	24.2	18.2
Current liabilities:					
Bank overdraft	--	5.6	--	1.2	0.3
Short term loans	3.1	2.7	2.8	3.3	4.3
Trade payables	24.8	22.1	28.9	21.0	20.4
Provisions	0.4	0.4	0.4	0.5	0.5
Total current liabilities	31.7	34.7	33.1	38.2	40.0
Total equity and liabilities	100.0	100.0	100.0	100.0	100.0

(c) Net operating cycle for 2019

Net operating cycle is calculated as follows:

Net operating cycle = Number of days of inventory + Number of days receivables – number of days payable

Calculation of number of days in inventory:

$$= \frac{\text{Inventory}}{\text{Average list of goods sold per day}}$$

$$= \frac{\text{Inventory}}{\text{Cost of goods sold/365}}$$

$$= \frac{54}{419.6/365}$$

= 47 days

Calculation of number of days in receivables

$$= \frac{\text{Accountings receivables}}{\text{Average days of sales on credit}}$$

$$= \frac{\text{Accounting receivables}}{\text{Sales on credit/365}}$$

$= \dfrac{122.3}{797.3/365}$

= 56 days

Calculation of number of days in payable

$= \dfrac{\text{Accounts payable}}{\text{Average days purchases}}$

$= \dfrac{\text{Accounts payable}}{\text{Purchases}/365}$

Purchases = cost of sales – opening stock + closing stock.

= 419.6 – 54.8 + 54 = 418.8

Number of days payable

$= \dfrac{120.1}{418.8/365}$

= 105 days

Therefore, act operating cycle

= {(47 + 56) – 105} days

= -2days

(d) Trend analysis using ratios

	2015	**2016**	**2017**	**2018**	**2019**
Performance:					
(i) Gross profit margin	$\frac{203.0}{489.9}\%$	$\frac{250.8}{583.5}\%$	$\frac{283.9}{665.4}\%$	$\frac{316.1}{716.6}\%$	$\frac{377.7}{797.3}\%$
=	41.44%	42.98%	42.67%	44.11%	47.37%
(ii) Net profit margin	$\frac{105.9}{489.8}\%$	$\frac{125.2}{583.5}\%$	$\frac{138.4}{665.4}\%$	$\frac{147.2}{716.6}\%$	$\frac{187.6}{797.3}\%$
=	21.62%	21.46%	20.80%	20.54%	23.53%
(iii) Returns on capital employed	$\frac{102.6}{263.8}\%$	$\frac{129{,}9}{289.2}\%$	$\frac{149.2}{336.6}\%$	$\frac{171.0}{324.3}\%$	$\frac{209.7}{353.8}\%$
=	40.79%	44.92%	44.32%	52.73%	59.27%
Efficiency:					
(i) Net asset turnover	$\frac{489.8}{263.8}\%$	$\frac{583.5}{289.2}\%$	$\frac{665.4}{336.6}\%$	$\frac{716.6}{324.3}\%$	$\frac{797.3}{353.8}\%$
=	1.9	2.0	2.0	2.2	2.3
(ii) Inventories turnover	$\frac{286.8}{49.5}\%$	$\frac{332.7}{43.9}\%$	$\frac{381.5}{49.3}\%$	$\frac{400.5}{54.8}\%$	$\frac{419.6}{54.0}\%$
=	5.8	7.6	7.7	7.3	7.8
(iii) Receivable turnover	$\frac{489.8}{54.9}\%$	$\frac{583.5}{67.3}\%$	$\frac{665.4}{89.4}\%$	$\frac{716.6}{116.6}\%$	$\frac{797.3}{122.3}\%$

	=	8.9	8.7	7.4	6.1	6.5
(iv)	Payable turnover	$\frac{286.8}{95.6}\%$	$\frac{332.7}{97.7}\%$	$\frac{381.5}{145.4}\%$	$\frac{400.5}{110.3}\%$	$\frac{419.6}{120.1}\%$
	=	3.0	3.4	2.6	3.6	3.5
Position						
(i)	Current ratio	$\frac{111.0}{122.3}\%$	$\frac{131.7}{153.4}\%$	$\frac{173.4}{166.2}\%$	$\frac{186.9}{200.2}\%$	$\frac{243.6}{235.5}\%$
	=	0.90:1.00	0.86:1.00	1.04:1.000	0.93:1.00	1.03:1.00
(ii)	Acids test	$\frac{61.5}{122.3}\%$	$\frac{87.8}{153.4}\%$	$\frac{124.1}{166.2}\%$	$\frac{132.1}{200.2}\%$	$\frac{189.6}{235.5}\%$
	=	0.50:1.00	0.57:1.00	0.75:1.00	0.66:1.00	0.81:1.00
(iii)	Gearing ratio	$\frac{148.3}{263.8}\%$	$\frac{148.0}{289.2}\%$	$\frac{171.9}{336.6}\%$	$\frac{127.4}{324.3}\%$	$\frac{107.3}{353.8}$
	=	0.56	0.51	0.51	0.39	0.30
(iv)	Interest cover	$\frac{107.6}{1.7}$	$\frac{129.9}{4.7}$	$\frac{149.2}{10.8}$	$\frac{171.0}{23.8}$	$\frac{209.7}{22.1}$
	=	63.3	27.6	13.8	7.2	9.5

EXAMINER'S REPORT

The question is in four parts. Part (a) test candidates' knowledge of steps necessary to carry out financial analysis, part (b) is to prepare common size ratio, part (c) is on computation of operating cycle while part (d) is preparation of trend analysis using financial performance ratios.

The candidates show clear understanding of the question since the question is straight forward, however, the candidates could not perform well, therefore, performance was average.

The commonest pitfalls of the candidates were:

(i) In part (a) of the question most candidate cannot list the requirements of financial analysis;

(ii) In part (b) of the question, majority of the candidates exhibit inadequate knowledge of the question; and

(iii) In part (d) of the question majority of the candidates were unable to compute the ratios correctly.

Candidates are advised to study diligently for good performance in future examination.

2. Each corporate organisation must plan so as to reduce its overall tax liability.

Required:

(a) Itemise Seven (7) components of corporate tax planning. (7 Marks)

(b) List Eight (8) objectives of corporate tax planning. (8 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) Corporate tax planning includes:

(i) Proper understanding of the provisions of the tax laws;
(ii) Analysis of, management and optimisation of the effective tax rate (ETR);
(iii) International tax strategy, that is, choice of the method used to open offices/plants and determine location;
(iv) Tax management;
(v) Computation of taxable income
(vi) Handling of challenges associated with tax consolidation;
(vii) Optimisation of financing and management of debt ratios;
(viii) Management of flow of dividend, interest and royalties;
(ix) Optimisation of tax losses/securing the deductibility of interest expenses and acquisition costs;
(x) Taking benefits of tax agreements, international double taxation, etc;
(xi) Taking into consideration tax effect of acquisition, disposal of business and/or business restructuring;
(xii) Management of relationship with the tax authorities for tax optimisation by avoiding late filings, late payment of taxes, etc; and
(xiii) Giving consideration to all tax incentives available with a view to take advantage of these incentives as much as possible.

(b) Objectives of tax planning are:
(i) Lower current year's tax;
(ii) Defer current year's tax to future years;
(iii) Reduce tax in future years;
(iv) Maximise tax saving from allowable deduction;
(v) Taking advantage of all available tax incentives;
(vi) Maximise the amount of wealth that stays in your family;
(vii) Free up cash for investment, business or needs by deferring your tax liability; and
(viii) Manage cash flow by projecting when tax payments will be required.

EXAMINER'S REPORT
The part (a) of the question tests candidates on the component of tax planning while part (b) was on the objectives of tax planning. About 95% of the candidates attempted the question. Majority of the candidates understood the requirements of the question and performance was average. The commonest pitfall of the candidates was their inability to distinguish between objectives and components of tax planning.

Candidates need to read very well and identify the distinguishing features of component of tax planning and objectives of tax planning.

3. It is a common knowledge that there are always gaps in accounting profits and tax profits.

Required:
Discuss the various reasons for gap in company's accounting profit and tax profit.
(15 Marks)

SOLUTION TO QUESTION 3
Accounting profit is calculated based on revenues and related costs of doing business. There are several components that go into calculating accounting profit. Gross profit is the difference

between revenue and cost of sale, or cost of producing the goods. Companies subtract all other expenses from gross profit to arrive at accounting profit before tax expense.

Operating expenses include rent, utilities, interest depreciation amortisation, salaries and other day-to-day costs of running the business. The matching principle is followed in reporting accounting profit. This principle ensures that income generated by on output and the expenses incurred for that output are recognized in the same period whether they were paid for or not during the period.

Each company is allowed under the tax law to select the date for its financial reporting, i.e. its accounting period which sometimes differ from the government fiscal year. Corporate financial reporting is required to follow accounting standards that have been set by independent accounting standard body. The purpose of these standards is to ensure uniformity of companies' financial statements and accounting methods.

However, tax rules are contained in tax laws as promulgated by the country' legislature and are mostly different from the requirements of accounting standards. Therefore, it is possible for the financial report of a company to differ from the tax returns submitted to tax authority because of the different accounting methods.

The gap or difference between accounting and tax profit generally results from three categories of difference. These are:
(i) Temporary differences;
(ii) Permanent differences; and
(iii) Loss carry forward/carry backs

Temporary differences are defined by the accounting standard as being differences between the carrying amount of an asset (or liability) within the statement of financial position and its tax base, i.e. the amount at which the asset (or liability) is valued for tax purposes by the relevant tax authority.

Permanent differences occur as a result of differences between income as reported in the financial statement and income as reported based on tax law, as a result of some expenses that are disallowed for tax purpose but included in the determination of income in the financial statements. Also, there are some expenses and or income reported on the tax return which are never reported on the statement.

EXAMINER'S REPORT
The question tests the candidates' knowledge of the various reason why accounting profit differs from tax profit. The question is very straightforward. Only about 40% of the candidates attempted the question and performance was below average. The commonest pitfall was that the candidates mistook the factors that can cause difference as only depreciation and capital allowance.

Candidates are advised to read the study pack and study very well for future examination.

4. (a) There are many provisions for tax incentives under the Nigeria tax laws.

Required:
List Five (5) tax free dividends incentives under the Nigeria tax law. (5 Marks)

(b) Many countries, including Nigeria, always go into tax agreements, called treaties.

Required:
List Three (3) reasons why government enters into tax treaty. (3 Marks)

(c) There are many anti-avoidance regulations under the Nigeria tax laws.

Required:
Discuss anti-avoidance scheme on payment of dividend to shareholders under the Nigerian Companies Income Tax Act. (4 Marks)

(d) Discuss how profits are taxed and distributed to shareholders of limited liability companies. (3 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) The incentives on tax free dividend in the Nigeria tax laws are:

(i) Three years tax free dividend on foreign currency equity ordinary shares imported into Nigeria;
(ii) Five years tax free dividend for companies in priority sectors in Nigeria such as agricultural production and processing, petrol chemical or liquefied natural gas production;
(iii) Tax free dividends for pioneering companies for the period of tax holidays;
(iv) Dividend distributed by unit trust companies;
(v) Five years tax incentive for dividends from companies in the manufacturing sector;
(vi) Dividends received from investments in wholly export oriented businesses.
(vii) Dividend, interest, rent and royalty derived from foreign companies; and
(viii) Profit of the Nigerian company in respect of goods exported from Nigeria provided that the proceeds are repatriated to Nigeria and used for the purchase of raw materials, plant equipment and spare parts.

(b) Reasons only government enters into tax agreement are:

(i) To eliminate double taxation through the granting of credit for the tax paid by a Nigeria company in the other country;
(ii) To protect tax incentive legislations of the government which would otherwise be nullified by the tax measure of the other country;
(iii) To allow for stable tax regime; and
(iv) The concession of treaty-rules for investment income which are lower than domestic rates and are available to treaty partners only.

(c) Under the Nigerian Companies Income Tax Act, section 19(a) and (b), we have provision for anti-avoidance in respect to dividends payment. It provides that:

"Where a dividend is paid out of profits on which tax is not payable due to:

- No total profit; or
- Total profits which are less than the amount of dividend which is paid, whether or not the recipient of the dividend is a Nigeria company.

The company paying the dividend shall be charged to tax at normal company rate (which is 30%) as if such dividend is the total profits of the company for the year of assessment.

(d) A limited liability company is a separate legal entity from its owners, called shareholders. A limited liability company is assessable to tax on the profit it made on yearly basis. It is the after tax profit that is available for distribution between the shareholders. However, a limited liability company may choose not to distribute any part of the after tax profit. The company's board, subject to the approval of the shareholders determine how much of the after tax profits that would be distributed to the shareholders and the form they will be distributed.

A company can distribute profits to shareholders in two forms:

(i) Cash distribution is the form of dividends, where cash is distributed as dividend, a tax of 10% is deducted inform of withholding tax which is treated as a final tax in the hands of the shareholders. This is paid to the relevant tax authorities.

(ii) Capital distribution in form of bonus shares or script issues. In this case, cash is not paid to the shareholders, but the amount that could have been paid as dividend is used to credit the accounts of the shareholders with additional shares in proportion to their shareholdings. In this case, a shareholder who is in need of cash can early sell the additional shares on the stock exchange. At present, the gain from such disposed of is not subject to capital gain tax.

EXAMINER'S REPORT

The question was in four parts. Part (a) test the candidates' knowledge about free dividend incentive, part (b) was on tax treaties, part (c) on anti-avoidance regulations while part (d) was on how profit are taxed and distributed to shareholders of limited liability company.

Majority of the candidates did not understand the part (a) of the question while about 70% understood part (b) and (c) of the question. And less than 50% understood part (d) of the question. However, the performance on this question was below average.

The commonest pitfall was candidates' inability to highlight the various free dividend incentives and reasons for tax treaty.

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

5. A Corporate entity can grow its business using many strategies.

Required:

(a) List Five (5) ways of growing business. (5 Marks)

(b) Discuss Five (5) barriers that must be taken into consideration when expanding business internationally. (10 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 5

(a) The various ways of growing business are:

(i) Increasing sales and products in existing market;

(ii) Introducing a new product offering in a new market;

(iii) Offering existing products in a new market segment;

(iv) Start a chain, e.g. a restatement chain, a super market chain, etc;

(v) Franchising

(vi) Strategic alliance and acquisition; and

(vii) Going global

(b) The barriers to be taken into consideration when expanding business internationally are:

(i) Language barriers: Although it may seem simple at the outset to translate the features of a given product or service into local language, marketing the product or service may present unforeseen difficulties of the concept itself does not "translate well the target country's standards for humor, accepted puns or jargon, or even subtle gestures may not be the same as your domestic country's norms or idioms and may need to be adjusted accordingly.

(ii) Marketing barriers: These types of barriers most frequently go to the deepest cultural levels. For example, whereas many overseas markets have developed a taste for "Cart Food" buyers and hot dogs, differences in culture may dictate that the speed aspect in less important. Many cultures demand the leisure to be able to relax on the premises after eating a meal rather than taking a meal to go. These cultural norms can, in turn, be affected by factors such as the cost and availability of retail space. Direct and subtle messages in advertising campaigns may need to be modified. The appeal of using a particular celebrity in a campaign may vary, and the channels for promotion may also need to be modified, to meet the educational patterns and needs of the local consumer. Even marketing methodologies need to be modified.

(iii) Legal barriers: The company or its counsel must research tax laws, customs laws, import restrictions, corporate organisation, and agency liability laws. Domestic legislation needs to be examined as well for issues arising under labour law, immigration law, customs law, tax law and other producer/distributor liability provisions.

(v) Access to raw materials and human resources. Not all countries offer the same levels of access to critical raw materials and skilled labour that may be needed to offer the service or enjoy the product. The growing company may want to consider what changes without sacrificing the core business formal.

(vi) Government regulatory barriers: The foreign government may or may not be receptive to foreign investment or expansion. A given country's past history of expropriation, government restrictions and limitations on currency repatriation may all prove to be decisive factors in determining whether the cost of market penetration is worth the benefits to be potentially derived.

(vii) Intellectual property and quality control concerns: Protection of trademarks, trade names, and service marks are vital for the ability of an emerging growth company to operate abroad. The company needs to have a strategy in place for both protecting its intellectual property rights and enforcing them if violation are discovered.

(viii) Dispute resolutions: The forum and governing law for resolution of disputes must be chosen. On an international level, these issues become mostly negotiated due to the inconvenience and expense to the party who must come to the others forum.

EXAMINER'S REPORT

The question tests the candidate knowledge of ways to grow business and the barriers that must be taken into consideration in expanding business internationally. The question is very straightforward despite this, majority of the candidates could not highlight ways to grow business and expand it internationally. Therefore, performance of majority of the candidates was below average.

Candidates are advised to read and prepare very well for future examination.

6. One of the decisions corporate entity must make is financing decision.

Required:

(a) Discuss entity's financing decision and the Two (2) types of financing open to an entity. (6 Marks)

(b) Apart from outright cash purchased, discuss Three (3) ways a company may acquire non-current assets. (9 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 6

(a) Financing decision is decisions as to when, where, from and how to acquire foods to meet an entity's investment needs. The focus of the finance manager here is determination of the appropriate proportion of equity and debt. Financing describes the sourcing of all funds a company uses for acquiring assets and paying expenses.

These are only two kinds of sources of funds, equity and debts funding. The company's financial structure describes the fractions funds, of total funding that comes from each source. Equity comes from two sources-paid up share capital and retained earnings the after tax profits retained by the company in the business after paying dividends to shareholders. Debits are funds acquired through debt financing and come primarily from bank loans and sales of debenture stock or loan notes. The company's debts, however, also includes short term obligation such as short term loan, loan notes payable within the year, account payable, etc.

(b) Assets finance is a type of finance used by businesses to obtain the equipment they need to grow. Apart from outright cash purchase, a company can acquire assets in the following ways;

(i) Leasing: This is a form of asset finance where a leasing company (called the lessor) buys and sometimes, hiring the asset on behalf of the customer (called the lessee). The lessee pays a rental for the use of the asset over a predetermined period. There are two types of lease:

- Finance lease: Under finance lease, the lessee owns the asset and the asset appears on the statement of financial position of the lessee. The lessee pays rental, which is the addition of the principal amount and the interest element over a period of time. In finance lease, the lessor is responsible for all the risks of ownership and also maintains the asset. At the end of the lease period, the lessee will pay a token to the lessor and the asset become that of the lessee permanently. It is almost like taking a loan to buy the asset needed.

  Under the Nigerian tax laws, the lessee will claim capital allowance for the cost of the asset while the interest claims is charged to the income statements the cost of the assets is treated as non-current asset in the statement of financial position of the lessee.

- Operating Lease: This is a situation where the lessee do not own the asset but is allowed to use the asset over a period of time by paying a regular rental to the finance company or lessor. The asset does not appear on the statement of financial position of the lessee and rental paid is charged into the income statement against profit.

  Under the Nigerian tax laws, the lessee cannot claim capital allowances on the asset, since he does not own the asset. However, rental payment is an allowable expense for tax purpose. The lessee does not assume risk for the asset and may not be responsible for maintaining the asset.

(ii) Hire Purchase: Hire purchase agreement allows a firm to buy an asset on credit. The finance company will buy the asset on behalf of the customer and the finance instalment is paid. Under hire purchase agreement, the hirer will use the asset and is given as option to buy the asset at the end of the hire period by paying a nominal sum for the asset.

Under hire purchase agreement, the finance company can re-possess the asset if the hirer default in its instalmental payment.

A hire purchase agreement is a credit sale agreement by which the owner of the asset or supplier grant the purchaser the right to take possession of the asset but ownership will not pass until all the hire purchase payments or instalments have been made. The hire purchase payments consist partly of capital payments towards the purchase of the asset and partly of interest charges.

Under the tax law, the hirer can only claim capital allowance on the capital amount of the asset that have been paid while the interest element will be charged to the income statement as an allowable expense.

(iii) Credit Purchases: A company can buy an asset on credit from the supplier based on agreement. The credit period may be one or more months. Under credit purchase, the asset belong to the purchaser and the supplier is simply treated as account payable. The supplier cannot take re-possession of the asset, he can only sue for the payment of amount owing.

Under the tax law, the purchaser is treated as having purchased the asset and all capital allowances due will become claimable.

EXAMINER'S REPORT

The question tests the candidates' knowledge of finance decision and ways to finance the acquisition of assets. The question is a straight forward question with no ambiguity. Ninety percent of the candidates attempted the question. However, only about 50% understand the requirements of the question and performance was average.

The commonest pitfall was candidates' inability to know how to finance the acquisition of assets.

Candidates are advised to read the Study Pack of the subject and study Pathfinders of past examinations when preparing for future examination.

7. The conceptual framework, underpinning regulation of published financial statements, states that information contained in the statements should have certain specified, qualitative characteristics.

 Required:
 Discuss these characteristics. (15 Marks)

SOLUTION TO QUESTION 7

According to the conceptual framework information in the financial statements should have the following qualitative characteristics:

(i) Appropriateness: Appropriateness means the efficiency of financial statements and reports, and their success in serving their users through their ability to provide adequate and appropriate information to make appropriate decisions, so that this information is recognized for being suitable for decision-making and is presented properly and timely.
(ii) Reliability: Reliability is associated with the information integrity and the ability to rely on it. Accounting information is characterised as being reliable or can be relied on if it has the ability to express the veracity of the information, to be free from error and bias, and to represent it fairly and honestly.
(iii) Consistency: This characteristic is realised when the company uses the same accounting treatment for the same event from one period to another for easing comparison of organisational performance over a period of time.
(iv) Understand ability: It is a qualitative accounting information characteristic that helps a prudent user to identify the meaning and importance of financial reporting.
(v) Comparability: This characteristic enables users of financial reports to identify similarities and differences between economic phenomena and events. The use of an incomparable accounting standard results in increased differences in the expression of economic phenomena and events.

EXAMINER'S REPORT

The question tests candidates' knowledge of qualitative characteristic of published financial statements. Candidates understood the question and about 80% of the candidates attempted the question. Over 50% of the candidates performed above average. Few candidates did not fully understand the quantitative characteristics of financial statements.

Candidates are advised to create time to prepare for future examination adequately and make use of the Institute's Study Pack and Pathfinders of past examinations.