THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

OCTOBER 2022 PATHFINDER PROFESSIONAL TWO LEVEL

PTE II: INCOME TAX FOR SPECIALISED BUSINESS

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

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

1. Eket Petroleum (Nig.) Limited is an oil producing company. Extracts from the books of the company for the accounting period 1 January to 31 December, 2020 are as follows:

   (i) The company produced 5,000 barrels of crude oil per day during 2020 (a leap year) of which 90% was exported while the remaining 10% was sold in the local market. The selling price for the local market was ₦40 per barrel.

   (ii) The posted price of crude oil at the standard API gravity of 35^0 was \$22 per barrel and it had been agreed that for every degree increase or decrease in the API gravity, the posted price will be amended by \$0.05. The crude oil produced had API gravity of 32^0.

   (iii) Incidental income from petroleum operations amounted to ₦2,970,100.

   (iv) The rate of exchange was ₦100 = \$1.

   (v) The following expenses were incurred by the company:

	₦
Production expenses	525,600,000
Administrative expenses	382,850,000
Cost of drilling 4 appraisal wells	85,000,000
Bad debts written off	18,000,000
Allowance for doubtful debts	7,000,000
Non-productive rent	16,000,000
Royalty on export sales	179,935,000
Royalty on local sales	366,000
Depreciation	21,000,000
Custom duties on essential imported equipment	192,000

(vi) Losses from petroleum operations brought forward are as follows:

	₦
2015	14,100,000
2016	18,500,000
2017	14,300,000
2018	11,800,000
2019	17,400,000

(vii) Schedule of qualifying capital expenditure in respect of petroleum operations:

	Up to 100m	100 - 200m	Above 200m
	₦	₦	₦
2014	7,000,000	9,000,000	
2016	25,000,000		
2018		14,000,000	5,000,000
2020	15,000,000	20,000,000	10,000,000
	47,000,000	43,000,000	15,000,000

(viii) The company operated ocean going tankers for the transportation of crude oil for other companies from Nigeria to other countries. The company earned ₦8,300,000 from the transportation of chargeable oil. Expenses relating to the transportation of crude oil included in administrative expenses amounted to ₦2,350,000.

Required:

Compute the following:

(a) Adjusted profit (7 Marks)

(b) Assessable profit (2 Marks)

(c) Petroleum investment allowance (9 Marks)

(d) Annual allowance (5 Marks)

(e) Chargeable profit (6 Marks)

(f) Petroleum profits tax (1 Mark)

(g) Companies income tax (4 Marks)

(h) Tertiary education tax (6 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

Eket Petroleum (Nig.) Limited
Computation of Petroleum Profits Tax for the Accounting Period
1 January to 31 December, 2016

		₦	₦
	Value of crude oil sold (W1)		
	- Export sales		3,598,695,000
	- Local sales		7,320,000
	Incidental income		2.970,100
			3,608,985,100
	Less allowable expenses:		
	Production expenses	525,600,000	
	Admin. expenses (₦382,850,000 – ₦2,350,000)	380,500,000	
	Cost of drilling 2 appraisal wells (2/4 x N85,000,000)	42,500,000	
	Bad debts written off	18,000,000	
	Non-productive rent	16,000,000	
	Royalty on export sales	179,935,000	
	Royalty on local sales	366,000	
	Customs duties	192,000	
	Tertiary education tax	46,466,512	1,209,559,512
(a)	Adjusted profit		2,399,425,588
	Less losses brought forward		76,100,000
(b)	Assessable profit		2,323,325,588
	Less capital allowances – lower of:		
	Petroleum investment allowance	6,500,000	
	Annual allowance	17,550,000	
		24,050,000	24,050,000
	And		
	85% of assessable profit (i.e. 85% x N2,323,325,588)		
		1,974,826,750	
	Less 170% of PIA (i.e. 170% x N6,500,000)		
		11,050,000	
		1,963,776,750	
(c)	Chargeable profit		2,299,275,588
(d)	Petroleum profits tax = 85% of chargeable profit (i.e. 85% x 2,299,275,588)		1,954,384,250
(e)	**Companies income tax**		
	Income from transportation of crude oil		8,300,000
	Less transportation expenses of crude oil		2,350,000
	Assessable/Taxable profit		5,950,000
	Companies income tax (30% x N5,950,000)		1,785,000

(f) Tertiary Education Tax

Petroleum operations

Profit of accounting period (total income)	3,608,985,100
Less allowable expenses (excluding education tax)	1,163,093,000
Adjusted profit before tertiary education tax	2,445,892,100
Less loss relief	76,100,000
Assessable profit before tertiary education tax	2,369,792,100
Tertiary education tax – 2/102 x ₦2,369,792,100	46,466,512
Non-petroleum operations	
Tertiary education tax (2% x ₦5,950,000)	119,000

(g) Petroleum Investment Allowances (PIA)

	Qualifying Expenditure	%	PIA
	₦		₦
Up to 100m of water depth	15,000,000	10	1,500,000
Between 100 – 200m of water depth	20,000,000	15	3,000,000
Above 200m of water depth	10,000,000	20	2,000,000
			6,500,000

(h) Annual Allowance

Year of Expenditure	Qualifying Expenditure	Annual Allowance	
	₦	%	₦
2014	16,000,000		
2016	25,000,000	19 (5th Year)	4,750,000
2018	19,000,000	20 (3rd Year)	3,800,000
2020	45,000,000	20 (1st Year)	9,000,000
			17,550,000

Workings

(W1) Value of Crude Oil sold

Posted price

		$
Posted price at standard API gravity		22.00
Standard API gravity	35^0	
API gravity of crude oil produced	32^0	
Decrease in API gravity	3^0 @ $0.05	(0.15)
Posted price per barrel in $		21.85
Rate of exchange N100 = $1		
Posted price per barrel in Naira ($21.85 x N100)		₦2,185
Crude oil produced in 2016		
5,000 barrels per day x 366 days (leap year)		1,830,000 barrels
Export – 90% x 1,830,000		1,647,000 barrels
Local sales – 10% x 1,830,000		183,000 barrels

Value of crude oil sold

	₦
Export sales – 1,647,000 barrels x N2,185 per barrel	3,598,695,000
Local sales – 183,000 barrels x N40 per barrel	7,320,000
	3,606,015,000

Notes
(i) Cost of drilling the first 2 appraisal wells in a particular field is an allowable deduction.
(ii) Deduction of depreciation is specifically prohibited under PPTA 2004.
(iii) Annual allowance can only be granted on qualifying capital expenditure for 5 years, hence, no annual allowance is granted in respect of qualifying expenditure incurred in 2014.
(iv) General provision for bad debts is not an allowable deduction.

EXAMINER'S REPORT
The question is a compulsory for all the candidates. It tests candidates' knowledge of taxation of petroleum business.

About 98% of the candidates attempted the question. Candidates could be adjudged to understand the question based on their fair performance. About 60% of the candidates scored above average.

Candidates common pitfalls were in the area of identifying the disallowable expenses in the petroleum profit tax as well as the computation of capital allowance and petroleum investment allowances.

Candidates are advised to study the pathfinder produced by the Institute as well as the Petroleum Profit Tax Act especially the new amendments, when preparing for future examination.

2. CITN BANK PLC is a commercial bank that engages in money deposit banking services. The bank has investment in major stocks on the Nigerian Stock Exchange. An extract from the financial statements for the year ended 31 December 2019 is as shown below:

Particulars	**₦**
Interest income	119,683,638,000
Interest expenses	53,183,297,250
Profit before tax	34,606,816,500
Balancing charge	411,622,895
Litigation expenses	233,340,000
Agreed capital allowances	14,814,942,845

Included in the interest income are the following income received from:

AMCON bond htm	4,457,961,371
FGN bond trading	69,466,923
State govt bonds	943,088,190
Corporate bond	358,612,540
Euro bond- htm	53,258,518
State govt bonds	200,408,632
FMBN bond	40,037,607

Charges before arriving at the profit before tax:	
Depreciation	5,339,198,250
Amortisation	914,032,500
Impairment charges	7,956,975,000

Required

Compute the tax liabilities and levy for the relevant year of assessment. (15 Marks)

SOLUTION TO QUESTION 2

CITN BANK PLC
TAX COMPUTATION FOR 2020 YEAR OF ASSESSMENT

Particulars	₦	₦
Profit before tax		34,606,816,500
Add back non-allowable deduction		
Depreciation	5,339,198,250	
Amortisation	914,032,500	
Impairment charges	7,956,975,000	
Litigation expenses	233,340,000	14,443,545,750
		49,050,362,250
Less: non-taxable interest income:		
AMCON bond htm	4,457,961,371	
FGN bond trading	69,466,923	
State gov. bonds	943,088,190	
Corporate bond	358,612,540	
Euro bond-htm	53,258,518	
State gov. bonds	200,408,632	
FMBN bond	40,037,607	6,122,833,781
Assessable profit		42,927,528,469
Add: Balancing charge		411,622,895
Assessable profit		43,339,151,364
Less: Capital allowances		14,814,942,845
Total profit		28,524,208,519
Companies income tax (30% of total profit)		8,557,262,556
Tertiary education tax (2% of assessable profit)		858,550,569
MTD levy (1% of profit before tax)		346,068,165
(This levy is tax deductible when it is paid)		

EXAMINER'S REPORT

The question tests candidates' knowledge of computation of tax liabilities and levy payable on some financial instruments.

About 80% of the candidates attempted the question, while about 85% of them scored above average marks.

Majority of the candidates had a good understanding of the question hence the above average performance of the majority.

The commonest pitfall was candidates' lack of understanding of what constitute disallowable expenses.

Candidates are advised to cover the entire syllabus and work practical questions when preparing for future examination.

3. Worldwide Builders Limited was incorporated as a pioneer company in 2015 and commenced business as manufacturer of building materials on 1 January, 2016, which was certified as its production day. The pioneer period lasted till 31 December, 2018. The accounts for the four years ended 31 December, 2019 are as follows:

	2016	2017	2018	2019
	₦	₦	₦	₦
Gross profit	1,965,000	3,697,000	4,240,000	6,582,000
Less:				
Administrative expenses	983,000	1,144,000	1,192,000	2,860,000
Financial charges	650,000	1,215,000	1,450,000	1,305,000
Professional fees	80,000	158,000	140,000	280,000
Depreciation	200,000	320,000	292,000	292,000
Net profit	52,000	860,000	1,166,000	1,845,000

Additional information:

(i) Purchases of property, plant and equipment are as follows:

Asset	**No.**	**Year of purchase**	**Year of disposal**	**Cost/proceeds (₦)**
Motor vehicles	5	2015		1,500,000
Building	1	2016		1,000,000
Plant and machinery	3	2016		1,800,000
Furniture and fittings	4	2019		160,000

(ii) Dividend declared by the company for the years ended 31 December, 2017 and 2018 were ₦1 million and ₦3.5 million respectively.

(iii) Chief Otokoto is the Chairman/Chief Executive Officer of the company and owns 40% of the company's shares.

(iv) Worldwide Builders Limited is regarded as a medium-sized company based on section 105 of the Companies Income Tax Act.

Required:

(a) Compute the tax payable by the company for the relevant years of assessment. (13 Marks)

(b) Compute the tax payable by Chief Otokoto for 2017, 2018 and 2019 based on the dividend income. (2 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) Worldwide Builders Limited – Computation of Tax Liabilities Pioneer Period

Year of Assessment	Basis period and details	₦
2016	1/1/16 – 31/12/16	
	Adjusted profit	252,000
	Tax liability	Nil
2017	1/1/17 – 13/12/17	
	Adjusted profit	1,180,000
	Tax liability	Nil
2018	1/1/18 – 31/12/18	
	Adjusted profit	1,458,000
	Tax liability	Nil

The company is not liable to tax in 2016, 2017 and 2018 years of assessment because of the pioneer status (tax relief period of 3years) granted to the company. The aggregate profits of N2,890,000 made during the tax relief period are exempted form tax.

Non-pioneer period

YOA	Basis period and details	₦
2020	1/1/19 = 31/12/19	
	Adjusted profit	2,137,000
	Capital allowances	(2,541,500)
	Total loss	(404,500)
	Income Tax Liability	Nil
	Tertiary education tax (2% x ₦2,137,000)	42,740

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 2020 year of assessment. The company is liable to companies income tax at the rate of 20% because it is a medium-sized company.

b. Computation of Tax Liability of Chief Otokoto

Year of Assessment		₦
2017	Tax liability	Nil
2018	Tax liability	Nil
2019	Proportion of dividend received from pioneer company in 2018 in excess of exempted profits (see workings)	644,000
	Withholding tax (10% x 644,000)	64,400

Workings

(i) Computation of Adjusted Profits

	2016	2017	2018	2019
	₦	₦	₦	₦
Net profit	52,000	860,000	1,166,000	1,845,000
Add:				
Depreciation	200,000	320,000	292,000	292,000
Adjusted profit	252,000	1,180,000	1,458,000	2,137,000

(ii) Computation of Capital Allowances

	Motor vehicle	Building	Plant & machinery	Furniture & fittings	Total allowances
Rates: Investment allowance	--	--	10%	--	--
Initial allowance	50%	15%	50%	25%	
Annual allowance	25%	10%	25%	20%	
	₦	₦	₦	₦	₦
2020 YOA (1/1/19 – 31/12/19)					
Qualifying expenditure at 1/1/19	1,500,000	1,000,000	1,800,000	160,000	
Investment allowance					180,000
Initial allowance	(750,000)	(150,000)	(900,000)	(40,000)	1,840,000
Annual allowance	(187,500)	(85,000)	(225,000)	(24,000)	521,500
WDV c/f	562,500	765,000	675,000	96,000	--
					2,541,500

(iii) Dividend income of Chief Otokoto

	₦
Adjusted profits of 2016 credited to the account maintained for exempted profits (Section 17 account)	252,000
Adjusted profits of 2017 credited to the account maintained for exempted profits (Section 17 account)	1,180,000
Balance of exempted profits before payment of 2017 dividend 2017's dividend paid out of the exempted profits not subject to tax in the hands of the shareholders	1,000,000
Balance after payment of 2017 dividend	432,000
Adjusted profits of 2018 credited to the account maintained for exempted profits (Section 17 account)	1,458,000
Balance of exempted profits before payment of 2018 dividend	1,890,000
Total dividend paid out of 2018 account	3,500,000
2018's dividend paid in excess of the exempted profits	1,610,000
Proportion of excess dividend received by Chief Otokoto (40% x ₦1,610,000)	644,000

Notes

(i) The Industrial Development (Income Tax Relief) Act requires a pioneer company to maintain an account (often called section 17 account) which will be credited with amount of profits of the company exempted from tax. Any dividends paid out of the exempted profits shall not be subject to tax in the hands of the recipient shareholders. The dividend shall be debited to the account. Dividend paid in excess of the exempted profits credited to the account is liable to tax in the hands of the recipient shareholders.

(ii) Dividend is taxed on preceding year basis. Thus, dividend paid on 2018 accounts is taxable in 2019 year of assessment.

(iii) Dividend is subject to withholding tax only. Therefore, the withholding tax of N64,400 is the final tax due from Chief Otokoto.

(iv) Following the enactment of the Finance Act 2019, the basis of assessment for a new business is the preceding year basis. As such, the profit for 1/1/19 – 31/12/19 is assessed to tax in 2020.

(v) Qualifying expenditure after pioneer period.

	M. V.	Building	Plant & Machinery	Furniture & Fittings
	₦	₦	₦	₦
Pioneer Period Cost of assets acquired	1,500,000	1,000,000	1,800,000	160,000

(vi) Initial Allowance = Cost x Rate of Initial Allowance

(vii) Annual Allowance = $\frac{\text{Cost – Initial Allowance}}{\text{Number of Years for Annual Allowance}}$

EXAMINER'S REPORT

The question tests candidates' knowledge of computation of tax payable by a company and its promoter/chairman in a pioneer period of the company for the relevant years.

About 60% of the candidates attempted the question, but performance was poor.

Candidates appeared not to understand the requirements of the question hence the poor performance.

Pitfalls noticed were inability of candidates to compute capital allowance and determine the proportion of dividend recorded from pioneer company in 2018 in excess of exempted profits.

Candidates are advised to make use of the Institute's pathfinders for better performance in future examination.

4. Life Nigeria Insurance Company Plc is a life assurance company. The company provides insurance cover for life contracts. Below is the extract from the financial statements for the year ended 31 December 2020:

Particulars	**2020**
	₦
Actuarial surplus	617,104,040
Investment income	792,342,640
Fee income	123,781,840
Other operating income	4,519,760
Life fund account as at 31/12/2020	590,940,000
General reserves	85,086,540
Gross premium written	1,659,216,440
Profit before tax	564,605,440
Management expenses	316,389,080
Depreciation	19,921,440

Commissions paid	58,086,560
NITDA levy paid	428,986
Capital allowances claimable	16,592,164
Net liabilities on policies as at 31/12/2020	600,740,000
Administrative expenses	283,667,860

Required

Compute the taxes and levy payable for the relevant year of assessment, taking into consideration the relevant amendments to the tax laws. (Ignore VAT) (15 Marks)

SOLUTION TO QUESTION 4

Life Nigeria Insurance Company PLC
Computation of tax liability for the 2020 year of assessment

		₦	₦	₦
Actuarial surplus				617,104,040
Investment income				792,342,640
Fee income				123,781,840
Other operating income				4,519,760
Gross income				1,537,748,280
Deduct:				
(i)	General reserves	85,086,540		
	Add: Life fund account	590,940,000		
	Total of general reserve and life fund	676,026,540		
	Net liabilities on policies as at 31/12/2020	600,740,000		
	Amount claimable restricted to maximum of net liabilities on policies	600,740,000	600,740,000	
(ii)	Special reserve			
	The higher of:			
	1% of gross premium (1% of ₦1,659,216,440)	16,592,164		
	Or			
	10% of net profit (10% of ₦564,605,440)	56,460,544	56,460,544	
(iii)	Other allowable management expenses:			
	Management expenses	316,389,080		
	Commission paid	58,086,560		
	IT levy paid	428,986		
	Administrative expenses	283,667,860	658,572,486	(1,315,773,030)
	Assessable profit			221,975,250
	Less: Capital allowance			16,592,164
	Tax profit			205,383,086
	Companies income tax payable (30% of total profit)			61,614,925.80
	Tertiary education tax payable (2% of assessable profit)			4,439,505
	Information technology levy (1% of profit before tax)			5,646,054
	Minimum tax computation:			
	0.25% of gross income (0.25% of ₦1,537,748,280)			3,844,370.70

EXAMINER'S REPORT

The question tests the computation of taxes and levies payable for the relevant year of assessment in a life insurance company, taking into consideration, the relevant amendments to the tax laws.

More thank 81% of the candidates attempted the question, but the performance was poor.

Candidates' commonest pitfall was lack of understanding of the requirements of the question.

Candidates are advised to ensure that they cover the entire syllabus when preparing for future examination.

5. (a) Highlight the minimum tax provisions in the Companies Income Tax Act with reference to foreign shipping companies, insurances companies and other companies.

(b) The following is the income statement of Wealthy Unit Trust Scheme for the year ended 31 December, 2021.

	₦000	₦000	₦000
Investment income:			
Dividend received (gross)			5,600,000
Bank interest received (gross)			10,800,000
Rent received (gross)			11,000,000
Other income (profit on sale of property, plant and equipment)			200,000
			27,600,000
Less expenses:			
Staff salaries		12,800,000	
Managers' remuneration		5,600,000	
Depreciation		360,000	
Miscellaneous expenses:			
Preliminary expenses	240,000		
Diminution in the value of investments	400,000		
Subscription to the Association of Unit Trust Schemes	20,000		
Reserve for future investment	1,400,000		
Fine for contravention of financial regulations	28,000	2,088,000	20,848,000
Net profit			6,752,000

Required:

Compute the assessable profit of Wealthy Unit Trust Scheme for the relevant year of assessment. Withholding tax had been deducted at source from the investment income.

(15 Marks)

SOLUTION TO QUESTION 5

(a) Minimum Tax Provisions in the Companies Income Tax Act (as amended)

(i) Foreign shipping companies

The tax payable by any foreign shipping company for any year of assessment shall not be less than two per cent (2%) of the full sums receivable in respect of the carriage of passengers, mails, livestock or goods shipped in Nigeria.

(ii) Insurance companies

The minimum tax payable by an insurance company in any year of assessment is 0.25% or 0.5% of its gross turnover less franked investment income, depending on its accounting year-end.

For the purposes of computing minimum tax of non-life insurance business, "gross turnover" comprises gross premium and other income. "Gross premium" means the total premiums written, received and receivable, excluding unearned premium and premiums returned to the insured. "Other income" means all the income of the non-life insurance business other than gross premium (excluding franked investment income).

For the purposes of computing minimum tax of a life insurance business, "gross turnover" means gross income. "Gross income" means total income earned by a life insurance business including all investment income (excluding franked investment income), fees, commission and income from other assets but excluding premiums received and claims paid by re-insurers.

(iii) Other companies

A company is chargeable to a minimum tax if in any year of assessment the ascertainment of total assessable profits from all sources of a company results in a loss or no tax payable or tax payable which is less than the minimum tax.

The minimum tax rate is 0.25% or 0.5% of gross turnover of the relevant company less franked investment income, depending on its accounting year.

The foregoing provisions on minimum tax are not applicable to:

(a) a company carrying on agricultural trade or business;

(b) a company that earns gross turnover of less than ₦25,000,000 in the relevant year of assessment; and

(c) any company for the first four calendar years of its commencement of business.

(b) Wealthy Unit Trust Scheme

Computation of Assessable Profit for 2022 Year of Assessment

	₦'000	₦'000
Net profit per accounts		6,752,000
Less:		
Dividend received (franked investment income)	5,600,000	
Profit on sale of property, plant and equipment	200,000	5,800,000
		952,000
Add disallowable deductions:		

Depreciation	360,000	
Preliminary expenses	240,000	
Diminution in the value of investments	400,000	
Reserve for future investment	1,400,000	
Fine for contravention of financial regulations	28,000	2,428,000
Assessable profit		3,380,000

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 candidates' knowledge of minimum tax provisions in the Companies Income Tax Act with reference to foreign shipping companies, insurance companies and other companies. Performance was average.

Candidates' common pitfalls were lack of knowledge of the minimum tax provisions and inability to differentiate between disallowable expenses and allowable expenses.

Candidates are advised to ensure that they familiarise themselves with all the relevant tax laws when preparing for future examination.

6. Through its circular dated 29 April, 2021, the National Pension Commission (PENCOM) reviewed upward the minimum regulatory capital (shareholders' funds) for Pension Funds Administrators (PFAs) from the current one billion Naira (₦1,000,000,000) to five billion Naira (₦5,000,000,000), unimpaired by losses.

   The Commission also approved a 12-month transition period with effect from 27 April, 2021 within which PFAs are to meet the new minimum capital requirement.

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

   One of the PFAs in Nigeria, Solid Rock Pensions Limited, has announced its plans to acquire another PFA and to raise additional capital through the Nigerian Stock Exchange. Consequently, the Managing Director of the company has contacted your firm, Bassey & Co, Tax Consultants, for some advice.

   Required:

   Your mandate is to advise the Managing Director of the company on the tax implications of the following:

   (a) Cost of increasing the authorised share capital with the Corporate Affairs Commission. (4 Marks)

(b) Cost of obtaining approval from the relevant regulatory authorities, for example, the Nigerian Stock Exchange and Securities and Exchange Commission (SEC). (3 Marks)

(c) Acquisition of another PFA by Solid Rock Pensions Limited (8 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 6

Bassey & Co. Tax Consultants
No. 2 Mariga Street
River Park Estate
Abuja
28 February, 2020

The Managing Director,
Solid Rock Pensions Limited
No 2 Goodluck Jonathan Expressway
Abuja.

Dear Sir,

RE: TAX IMPLICATIONS OF INCREASING AUTHORISED SHARE CAPITAL AND ACQUIRING ANOTHER PENSION FUNDS ADMINISTRATOR

We refer to your request for our advice on the above subject matter and wish to respond as follows:

(a) In line with the National Pension Commission's directive, the company will have to increase its authorised share capital in order to meet the minimum capital requirement prescribed for each Pension Funds Administrator (PFA) in Nigeria. Any increase in the share capital will attract payment of relevant fees to the Corporate Affairs Commission as required by the Commission and stamp duties in line with the Stamp Duties Act. These costs of increasing share capital are capital in nature and will not be treated as allowable deductions in computing the assessable profits of the company.

(b) The costs of obtaining approval from regulatory authorities like the Nigerian Stock Exchange and Securities and Exchange Commission (SEC) are also capital in nature and are not to be treated as allowable deductions in computing the company's profits for tax purposes.

(c) Acquisition of Pension Funds Administrator (PFA)
Where Solid Rock Pensions Limited acquires or absorbs another PFA, it means that the acquired company will go out of existence, while the acquirer (Solid Rock Pensions Limited) will continue to exist in business. Solid Rock Pensions Limited:
  (i) Must file its returns as an existing company in line with the provisions of CITA;
  (ii) Will not be deemed to have commenced business and the commencement provisions will not apply to it since it is continuing in the same insurance business;

(iii) Will not be entitled to investment allowance and initial allowance on the assets transferred to it. It will only be entitled to claim annual allowance on the tax written down values of the transferred assets;

(iv) May not be allowed to carry forward the unabsorbed losses and capital allowances if any of the acquired Pension Fund Administrator and set off against its assessable profits after the acquisition; and

(v) Will have to deduct withholding tax from fees paid for professional services in connection with the acquisition and remit to the relevant tax authorities. The company will also pay stamp duties for increase in the share capital.

The PFA acquired or absorbed by Solid Rock Pensions Limited:

(i) Will be deemed to have ceased business permanently and the cessation provisions will apply to it;

(ii) Can carried backward any unrelieved capital allowances at cessation and set off against the remainder of assessable profits (if any) for the five years preceding the year of cessation; and

(iii) Cannot carried backward any unrelieved losses at cessation and set off against the assessable profits of the preceding years of assessment.

Please note that section 29(12) of the Companies Income Tax Act 2004 (as amended) provides that no merger, take-over, transfer or restructuring of the trade or business carried on by a company can take place without having obtained the FIRS' direction and clearance with respect to any tax that may be due and payable under the Capital Gains Tax Act. We, therefore, advise that the company should obtain the consent or direction of the FIRS before finalising the acquisition arrangement.

Should you require any further explanation or clarification, please do not hesitate to contact us.

We wish to thank you for appointing us as your tax consultant and look forward to a lasting business relationship with your company.

Yours faithfully,
For: Bassey & Co. (Tax Consultants)

Edidiong Bassey
Principal Consultant

EXAMINER'S REPORT

The question in three parts, tests the candidates' understanding of:

(a) Cost of increasing authorised share capital with the Corporate Affairs Commission;

(b) Cost of obtaining approval from relevant regulatory authorities like Nigerian Stock Exchange and Securities and Exchange Commission for mergers and acquisition; and

(c) Practical handling of a merger and acquisition. Performance was poor, as candidates demonstrated lack of understanding of the question.

Candidates are advised to read relevant materials and cover the entire syllabus when preparing for future examination.

7. In the recent past, many foreign investors have shown interest in coming to invest in Nigeria in response to the invitations of the Federal and State Governments. For example, some white farmers from South Africa are interested in establishing large-scale farms and factories for processing agricultural products in Nigeria. Some State Governments are willing to offer them lands for their farm projects.

Most of the plant and machinery for the farm projects are to be imported, but the white farmers are also willing to use locally manufactured plant, machinery or equipment, if available. As the farm lands are situated in the rural areas, the white farmers may have to incur additional expenditure to provide some infrastructures, although the Federal and State Governments have promised to provide the necessary amenities within the shortest possible time.

The white farmers have approached you as a tax consultant to advise them on the tax incentives available to companies engaged in large scale farming and processing of agricultural products for export.

Required:
Advise the foreign investors on the tax incentives available to companies engaged in farming, processing of agricultural products, export-oriented businesses and companies located in rural areas as contained in the Companies Income Tax Act, Cap. C21, LFN 2004 and the Industrial Development (Income Tax Relief) Act, Cap. 17, LFN 2004 (as amended).

(Your correspondence should be addressed to the President, White Farmers Association of Nigeria). (15 Marks)

SOLUTION TO QUESTION 7

Yellow Sisi & Co.
(Chartered Tax Practitioners)
No. 2 Sweet Mother Street Ikom
Cross River State

1 March, 2022

The President
White Farmers Association of Nigeria
Ibom Avenue
Calabar
Cross River State

Dear Sir,

RE: TAX INCENTIVES AVAILABLE TO COMPANIES ENGAGED IN AGRICULTURE, PROCESSING OF AGRICULTURAL PRODUCTS AND EXPORT-ORIENTED BUSINESSES IN NIGERIA

Further to your request for our advice on the above subject matter, please find attached appendices I, II, III and IV which provide information on the incentives available to companies engaged in agriculture, manufacturing, exported oriented business and those located in rural areas, respectively. We hope that you will take advantage of these incentives. Please feel free to contact us if you require any further clarification or assistance.

Yours faithfully,
For: YELLOW SISI & CO.

Mrs. Sisi Gokana
Managing Partner

Appendix I
Incentives for companies engaged in agriculture

The incentives include the following:

(a) Unlike other companies which are required to pay minimum tax if they incur a loss, a company carrying on agricultural trade or business is exempted from the payment of minimum tax;

(b) The restriction of capital allowances claimable in a year of assessment of $66^{2}/_{3}$% of the year's assessable profit is not applicable to agricultural trade or business. 100% of capital allowances can be claimed in a year of assessment provided the assessable profit is sufficient to absorb the allowances;

(c) Interest on loan granted by a bank on or after 1 January, 1997 to a company engaged in primary agricultural production is exempted from tax provided the moratorium is not less than twelve months and the rate of interest on the loan is not more than base lending rate at the time the loan was granted, refinanced or otherwise restructured;

(d) Agricultural plant and equipment and plantation equipment are granted 95% initial allowance in the first year while the balance of 5% is retained in the books until the asset is disposed of. Ranching and plantation expenditure attract annual allowance of 50%;

(e) Investment allowance of 10% is granted on qualifying expenditure on plant and equipment and

(f) Some agro-allied companies are granted pioneer status so that they are exempted from payment of income tax for three years and dividends paid from the exempted profits are not subject to tax in the hands of the shareholders.

Appendix II
Incentives for Companies engaged in manufacturing

The incentives include the following:

(a) The restriction of capital allowance claimable in a year of assessment to $66^{2}/_{3}$% of the year's assessable profit is not applicable to a manufacturing company. 100% of capital allowances can be claimed in a year of assessment provided the assessable profit is sufficient to absorb the allowances;

(b) Interest on loan granted by a bank on or after 1 April, 1980 for the purpose of manufacturing goods for export is exempted from tax on the presentation of a certificate issued by the Nigerian Export Promotion Council certifying that the company has achieved the level of export specified;

(c) Interest on any loan granted by a bank on or after 1 January, 1997 to a company engaged in the fabrication of any local plant and machinery or providing working capital for any cottage industry established by the company shall be exempted from tax provided the moratorium is not less than twelve months and the rate of interest on the loan is not more than the base lending rate at the time the loan was granted, refinanced or otherwise restructured;

(d) Many companies engaged in the processing of agricultural products are granted pioneer status so that they are exempted from payment of income tax for three to five years and dividends paid from the exempted profits are not subject to tax in the hands of the shareholders;

(e) Dividends received from small companies in the manufacturing sector in the first five years of their operation are exempted from tax; and

(f) Investment allowance of 10% is granted on qualifying expenditure on plant and equipment.

Appendix III
Incentives for companies engaged in export-oriented business

These include the following:

(a) Interest on loan granted by a bank on or after 1 April, 1980 for the purpose of manufacturing goods for export is exempted from tax on the presentation of a certificate issued by the Nigerian Export Promotion Council certifying that the company has achieved the level of export specified;

(b) 100% capital allowance is granted to a company in any year of assessment on qualifying expenditure on building, plant and equipment in an approved manufacturing activity in an Export Processing Zone. A company granted this capital allowance is not entitled to investment allowance under CITA;

(c) Dividend received from investment in wholly export-oriented businesses are exempted from tax;

(d) The profits of any Nigeria company in respect of goods exported from Nigeria are exempted from tax provided that the proceeds from such exports are used for the purchase of raw materials, plants, equipment and spare parts. Where the proceeds are not fully utilised in the manner prescribed, the profits to be exempt from tax shall be limited to the proportion of the proceeds utilised for the purchase of raw materials, plants, equipment and spare parts;

(e) The profits of a company whose supplies are exclusively inputs to the manufacturing of products for export are exempted from tax provided that the exporter gives a certificate of purchase of the inputs of the exportable goods to the seller of the supplies; and

(f) The profit of a company established within an Export Processing Zone or Free Trade Zone provided 100% production of such company is for export otherwise tax shall accrue proportionately on the profit of the company.

Appendix IV
Incentives for companies located in rural areas

Rural investment allowance is granted to a company that has incurred an expenditure on electricity, water or tarred road for the purpose of its trade or business which is located at least 20 kilometers away from such facilities which are provided by the government can claim rural investment allowance on such capital expenditure as follows;

(a)	No facilities at all	100%;
(b)	No electricity	50%;
(c)	No water	30%; and
(d)	No tarred road	15%

A company cannot claim both rural investment allowance and 10% investment allowance in respect of the same assets. Rural investment allowance is granted as a deduction from the profits of the year in which the facility was completed. Should there be no assessable profits in that year or assessable profits being less than the rural investment allowance, the unrelieved allowance cannot be carried forward to any subsequent year. It must lapse.

EXAMINER'S REPORT

The question tests candidates' knowledge of tax incentives available to companies engaged in farming, processing of agricultural products, export-oriented businesses and companies located in rural areas as contained in the Companies Income Tax Act 2004 and the Industrial Development (Income Tax Relief) Act 2004.

Almost 60% of candidates attempted the question. Performance was poor due to inadequate preparation.

Candidates' commonest pitfall was misinterpretation of the requirements of the question.

Candidates are advised to ensure they make use of the Institute's study pack and pathfinders when preparing for future examination.

PTE II: TAX AUDIT AND INVESTIGATION

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

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

1. Mr. Robert Smith has just been transferred to Nigeria as the Managing Director of Royco International Plc, a multinational company that has been operating in Nigeria for over forty (40) years. He succeeded Mr. Payne Anderson who was the Managing Director of Royco International Plc for ten 10 years in Nigeria.

Since his resumption in Nigeria, Mr. Robert Smith has been so interested in Nigeria tax system. Consequently, he requested for the tax correspondence file with the Federal Inland Revenue Service (FIRS) from the Finance Controller, Mr. Steve Bamidele. From the review of the files, Mr. Robert Smith noticed that the FIRS conducted desk audit of the company 2 years ago and additional assessment of ₦50m was paid to the FIRS.

He demanded for the reasons and details of ₦50m additional assessment paid and Mr. Steve Bamidele explained to him as best as he could.

As Mr. Robert Smith is trying to understand the rationale for the desk review and additional assessment of ₦50million paid, a letter of field tax audit notification was received from the FIRS and Mr Robert Smith was so confused that some of the years covered by desk review conducted 2 years ago are also included in the years to be audited in the notification letter.

Mr. Robert Smith was so disturbed with this development because he was not used to the development in his working carrier.

In view of the foregoing, Mr Robert Smith has directed the Finance Controller to invite you for a meeting, as the company's tax consultant, to further educate him on Nigerian tax issues.

As the company's tax consultants, you are required to make the following presentation that will form the basis of your discussion during the meeting with the Managing Director:

(a) Distinction between desk review/audit and field tax audit. (5 Marks)

(b) The legal basis for tax audit in Nigeria. (3 Marks)

(c) Objectives of tax audit to be conducted by the FIRS (10 Marks)

(d) The stages involve in typical field tax audit by the FIRS (12 Marks)

(e) Ten (10) documents usually requested for in FIRS field tax audit (10 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

(a). Distinction between desk review/audit and field tax audit

Desk audit or desk review is examination usually performed by the Federal Inland Revenue Service (FIRS). The FIRS tax officers sit in their office and examine the tax returns and accounts submitted by the taxpayer. Based on the review, the tax officer issue queries on the tax returns filed by the taxpayer and may request for additional information or documents from the taxpayers. In some cases, they may request the taxpayers to appear personally in the tax office to clear some issues in the returns filed. The outcome of desk review or desk audit may indicate the need to conduct a field tax audit.

On the other hand, a field tax audit or examination is usually conducted in the taxpayer's premises. It is more elaborate than the desk audit. It gives the tax auditors an opportunity to examine the relevant documents, accounts, schedule in the taxpayer's business premises and to obtain further information or explanation directly from the staff of the taxpayer. The tax auditor will be able to confirm whether the taxpayer has maintained books of accounts which are adequate for tax purposes. The tax authority usually notify taxpayers formally before field tax audit is conducted showing the date of the audit, the scope, years to be covered and documents required for the field tax audit.

(b). The legal basis for the tax audit is contained in the provisions of the Companies Income Tax Act (CITA) as amended and the Personal Income Tax Act (PITA) as amended which states that "Nothing in this section or in any other provision of the Act shall be construed as precluding the service from verifying by tax audit or investigation into any matter relating to any returns or entry in any books, documents, accounts, including those stored in a computer, digital or magnetic, optical or electronic media as may from time to time be specified in any guideline by the Service"

(c). The objectives of tax audit to be conducted by the Federal Inland Revenue Service (FIRS) are:

i. To ensure that adequate accounting books and records exist for the purpose of determining the taxable profit or loss of the taxpayer and consequently the tax payable;
ii. To confirm if the tax computations submitted to the FIRS by the taxpayers agree with the underlying records;
iii. To confirm if all applicable tax laws have been complied with by the taxpayer;
iv. To provide avenue to educate taxpayer on various provision of the tax law;
v. To discourage tax evasion;
vi. To detect and correct accounting and /or arithmetical error in the tax returns;
vii. To provide feedback to FIRS management on various provisions of the law and recommend possible changes;
viii. To identify cases involving tax fraud and recommend them for investigation;

ix. To forestall taxable person failure for render tax returns; and

x. To generate appropriate revenue for government / determine under payment.

(d) The stages involve in a typical FIRS field tax audit are:

(a). Pre- Audit:

i. Selection of taxpayers to be audited. In doing this, FIRS official may use various criteria for the selection of tax payers to be audited such as self – assessment taxpayer, sectorial or industry check, referrals from desk examination, random sampling, taxpayer with nil returns etc.

ii. Preliminary review of the selected taxpayer's file. The aim of this is to prepare the audit team that will be involved in the audit exercise for the task ahead. It involves obtaining basic information about the selected taxpayer, conduct of analytical review of the taxpayer's performance using ratio analysis and highlighting risk areas of the tax audit exercise; and

iii. Notification of taxpayer to be audited. The taxpayer to be audited will be notified formally. The notification letter will usually state the year or period the audit will cover, date of commencement of the audit and the list of records or document required for the audit. In practise, various conversation usually happens between the taxpayer to be audited and the FIRS officers to mutually agree on the field tax audit commencement date.

(b). Commencement of Tax Audit:

iv. Pre – Tax Audit meeting. The field tax audit usually commence with a preliminary meeting between the FIRS tax audit team and the management of taxpayer to be audited. The taxpayer Tax Consultants, where applicable, are expected to be presernt at this pre- audit meeting. The tax audit team leader is expected to chair the meeting while a member of the audit team is expected to take minutes of the meeting. The minutes of the meeting will be signed by the parties involved and each party will have a copy of the minutes of the meeting for their record purposes; and

v. Conduct of actual filed tax audit exercise. At this stage, the FIRS tax audit team will request for the production of documents/information for the audit. Documents provided by the taxpayer will be thoroughly examined, clarification are obtained and additional information and documents are requested for as applicable. During this stage also, areas of non-compliance with the extant provision of tax laws by the tax payer are noted.

(c). Conclusion of the Tax Audit

vi. Exit / Post tax audit meeting. This is usually conducted to signify the end of tax audit field work exercise. It is also called close out or exit meeting. The purpose of this meeting is to obtain any further outstanding information/document that may be available only from taxpayer's management and to answer outstanding questions that arose during the field audit work. The minutes of meeting should be documented in writing, signed by both parties and a copy given to both parties.

vii. Preparation and submission of the interim tax audit report. This report usually highlight details of all tax audit findings that may result in additional tax assessment as well as areas of possible dispute with the tax payer. Most often, taxpayers are given opportunity to respond to the interim tax audit report and make further submission.

viii. Reconciliation meeting. This is a meeting between the taxpayer and the FIRS tax audit team. The purpose of the meeting is to resolve all outstanding issues arising from the field tax audit exercise with a view to determining the additional tax due and resolving all disputes in accordance with the tax laws.

ix. Final Tax Audit Report. At the end of various reconciliation meetings, the final tax audit report will be written by FIRS and sent to the taxpayer. The report will state in details the additional assessment agreed at the reconciliation meeting as well as those disputed if any. The report will indicate details of how each additional assessment was arrived at. The report will form the basis for issuance of additional assessment.

(Note: sequential presentation)

(e). List of documents required for FIRS field tax audit are:

i. Audited accounts for the relevant years;
ii. Management Accounts;
iii. Chart of Accounts;
iv. Year end final Trial balance;
v. General ledger;
vi. Back up documents for entries in General ledger;
vii. Audit Adjustment journal;
viii. Sales invoice;
ix. Purchase invoice;
x. Payment voucher;
xi. Import documents;
xii. Fixed Assets Register;
xiii. Withholding Tax file;
xv. Bank Statement;
xvi. Minutes of Board of Directors meeting;
xvii. Stock / Inventory report;
xviii. Rent Agreement;
xix. Schedule of contract executed and agreement;
xx. Copies of tax returns filed for the relevant years
xxi. Company's incorporation documents with CAC;

xxii. Director Remuneration and expenses; and
xxiii. Expatriate Quota and Immigration Returns.

Examiner's Report

The question tests candidates' understanding of desk and field audits. Being a compulsory question, all the candidates attempted the question and performance was above average.

The commonest pitfall of candidates was inability to arrange the steps involve in field audit sequentially.

Candidates are advised to ensure they take time to observe the basic process and procedures that are important in tax audit when preparing for future examination.

2. PAYME is a Fintech company that has been in existence for a number of years in Nigeria. The economic landscape shows very good prospects for the company to thrive in the coming years. The Federal Inland Revenue Service (FIRS) has notified PAYME of its intention to conduct tax audit and the tax audit commencement date has been agreed by both parties.

Required:

(a) Explain why FIRS should consider the risks associated with PAYME business environment in conduct of its audit. (3 Marks)

(b) State Five (5) matters that FIRS should consider in order to have adequate understanding of PAYME business environment. (5 Marks)

(c) Enumerate Seven (7) tasks that would assist FIRS to adequately profile PAYME and the industry it operates in. (7 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) Federal Inland Revenue Service should consider the risk of the business environment of PAYME for the following reasons:

i. The tax auditor needs to assess the audit risks and identify likely challenges of the business and industry in which the taxpayer operates. Risks are essentially present in every business and industry, the seasonal and cyclical changes, whether, infrastructural needs, personnel and labour practices that are prevalent, input and raw materials supplies etc. and associated risks;
ii. Knowledge of the taxpayer to be audited is essential because it will assist in audit planning and performing the audit effectively and efficiently; and
iii. If risk associated with the business of PAYME are considered by the FIRS, it will enable the tax auditor to adopt appropriate approach for the audit.

(b) Matters to be considered by the FIRS in order to understand the FinTech company and its environment include:

i. Industry, economic environment, regulatory and other external factors, including the applicable financial reporting framework. Specifically, these are the market and competition, product technology, accounting principles, tax, legislation, etc.;

ii. Nature of the entity, this includes, whether a multinational, its revenue sources, products or service, locations, key customers and suppliers, financing sources, e-commerce, etc.;

iii. Objectives and strategies and related business risks. These include new products and services, expansion opportunities, deployment of information technology, etc.;

iv. Measurement and review of the entity's financial performance, by carrying out an analytical review showing performance trend analysis, ratios analysis, and comparison with key performance indicators (KPI), budgets and forecasts; and

v. Assessment of internal control systems in operation.

(c) Profiling of PAYME and the industry it operates involves the following tasks to be performed by the FIRS:

i. Review of basic tax information which includes determination whether:
   - The return was filed by due date;
   - Required schedules are / were completed;
   - Taxes were overdue; and
   - Financial statements have been filed with other statutory authorities.

ii. 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;

iii. Review financial statements, which should include; trend analysis on major accounts and calculation of important ratios;

iv. Review changes in paid-in capital and major shareholders;

v. Review inventories movements between affiliated companies;

vi. Review of transfer pricing issues if the taxpayer is a member of multinational, which involves:
   - Review the flow of funds to or through tax havens;
   - Examine arm's length dealings;
   - Research any Advance Pricing Arrangements.

vii. Review the taxpayer organisation chart, major products, functions of each department of enterprise, documentation relating to tax planning strategies, and taxpayer's use of e-commence;

viii. Review third party information, which includes, quarterly returns from banks, returns from customers, etc.; and

ix. Review of the current industry environment of the taxpayer relating to current market trend of the products, market position of the taxpayer, and indices of industry average.

Examiner's Report

The question tests candidates' understanding of audit risks associated with understanding the taxpayer's business and industry environment in preparation for tax audit. Few candidates attempted the question and performance was very poor.

Candidates demonstrated lack of understanding of the requirements of the question.

Candidates are advised that they should ensure adequate preparation by making use of the Institute's study Pack and Pathfinders when preparing for future examination.

3. Mr. Ogidiolu, the owner and Director of Afefeyeye Print-Media outlet based in Abuja, Nigeria has instructed the company's Accountant to restrain Federal Inland Revenue Service (FIRS) tax officials from gaining access to its premises and books since he believes that they are not in default of any tax liability.

Required:
As the Accountant of Afefeyeye Print-Media outlet, write a memo to the Director explaining the powers of FIRS to co-opt law enforcement officers to discharge its duties. (15 Marks)

SOLUTION TO QUESTION 3

Afefeyeye Print – Media
Abuja – Nigeria
Internal Memorandum

From: Accountant
To: Director (Mr. Tochukwu Ogidiolu)
Date: 01/01/00
Subject: Re: Restrain and the Position of Law.

As a company who believes in obeying the laws of our country, I wish to bring your attention to the position of the law concerning the exercise of restraining FIRS from getting access to our premises and books.

Section 36, sub-section 1 to 3 of the Federal Inland Revenue Service (Establishment) Act empowers Federal Inland Revenue Service (FIRS) to co-opt into the service in its discharge of enforcement duties, as follows:

(a). The services may co-opt the assistance and co-operation of any of the law enforcement agencies in the discharge of its duties under this Act;

(b). The law enforcement officers shall aid and assist an authorised officer in the execution of any warrant of distrait and the levying of distrait;

(c). Any tax officer armed with the warrant issued by a judicial officer and accompanied by a number of law enforcement officers as may be determined by the Executive Chairman shall:

   i. Enter any premises covered by such warrant and search for, seize and take possession of any book, document or other article used or suspected, to have been used in the commission of an offence;
   ii. Inspect, make copies of, or take extracts including digital copies from any book, record document or computer, regardless of the medium used for their storage or maintenance;
   iii. Search any person who is in or on such premises;
   iv. Open, examine and search any article, container or receptacle;
   v. Open any outer or inner door or window of any premises and enter or otherwise forcibly enter the premises and every part therefore; or

vi. Remove by reasonable force any obstruction, to such entry, search, seizure or removal as he is empowered to effect.

Conclusion

Since this is the position of the law, and as a responsible corporate entity, I therefore advice that we allow the FIRS and its enforcement agent to gain access to our premises and our books.

Best regards

Signature
Name xxxxxxx

Examiner's Report

The question tests the candidates' knowledge of the FIRS' power to enter any taxpayer's premises for the purpose of enforcement duties.

Many candidates attempted the question but performance was poor.

Candidates demonstrated poor understanding of the legal provisions of FIRS enforcement power.

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

4. Aboki Organic & Herbal Centre Limited usually deduct and remit withholding tax on all its payments and this notwithstanding, the State Internal Revenue service has approached the company to conduct a withholding tax audit.

Required:

(a) Enumerate Ten (10) audit procedures that a State Inland Revenue Service staff would follow for withholding tax audit. (10 Marks)

(b) Identify Five (5) benefits of the tax audit programme. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

The following procedures would be adopted by the State Internal Revenue Service to conduct tax audit of withholding tax:

i. Collect all the organisation's payment vouchers (both cash and cheque payment vouchers) month by month for the year;
ii. Arrange the vouchers serially or according to date order;
iii. Ensure that the vouchers are complete, either by seriality or date order;
iv. Ensure that attachments to the vouchers have not been detached from the vouchers;
v. Collect the revenue receipts for all withholding taxes remitted by the organisation to the state internal revenue during the year;
vi. Collect the following from the organisation:
    - List of suppliers, contractors, consultants, etc.;

- List of directors and their tax clearance certificate; and
- Rent schedule including rent agreements.

vii. Vouch the payment vouchers one by one to identify withholding tax payable by individual suppliers, contractors, consultants, etc. These include services or supplies by individual suppliers, contractors, consultants etc. It also include services or supplies by individual, partnership, enterprises, ventures or any unincorporated companies' resident in the state;

viii. List the withholding tax payable under the following categories:
- ✓ Contract and suppliers;
- ✓ Professional fees;
- ✓ Commissions;
- ✓ Director' fees;
- ✓ Dividends; and
- ✓ Rent and lease rentals.

ix. 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 providers;
- ✓ Description of the contract/supply/service;
- ✓ Gross amount on the invoice /bill;
- ✓ Rate of withholding tax payable; and
- ✓ Amount of withholding tax payable

x. Summarise and determine the total withholding taxes payable under each category and in total;

xi. Summarise the total withholding tax remitted by the organisation based on the withholding tax receipts collected / assessed;

xii. 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/ period under review.

(b) The objectives of tax audit programme are:

i. It is a time management tool;

ii. It shows details of work to be done by all members of the audit team;

iii. It provides information on how much of the audit work has been completed as at a particular date and how much is outstanding;

i. It provides an avenue for team leader to allocate his valuable staff in the most productive and effective manner possible;

ii. It provides a record of audit responsibility by providing a record of audit staff members responsible for each part of the completed works;

iii. It facilitate audit supervision and control giving the senior member of the audit team information and knowledge regarding the progress of the work done to date; and

iv. It ensures continuity in tax audit work should there be a change in the personnel constituting the tax audit team with new members being able to see at glance all the outstanding work to date thus providing a basis for planning and staffing the audit team.

Examiner’s Report

The question tests candidates’ knowledge of withholding tax audit procedures and importance of audit programme. About 90% of the candidates attempted the question but performance was poor.

The commonest pitfall was candidates; inability to itemise the procedures for withholding tax audit sequentially.

Candidates are advised that they should ensure they familiarise themselves with tax audit procedures when preparing for future examination.

5. (a) Explain the assessment procedures after tax audit. (4 Marks)

(b) Discuss succinctly the objection and appeal procedure for a disputed tax audit assessment. (6 Marks)

(c) List Five (5) contents of a notice of appeal to Tax Appeal Tribunal. (5 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 5

(a). The team leader submits the Assessment arrived at for final approval to his boss. Then, Notice of Assessment is prepared on the appropriate form showing relevant information/data like name of company, tax year, Assessment number, date, assessed amount etc. Notice of Assessment is served on the tax payer and the acknowledged copy returned to the tax office for reference sake and records.

(b). Where the taxpayer is aggrieved with assessment raised by the tax authority as a result of tax audit, the tax law make provision for the taxpayer to object to such assessment. However, to such objection to be valid, the following conditions must be met:

i. The objection must be in writing;
ii. The objection must be within thirty (30) days of the services of the notice of assessment; and
iii. The objection must state the grounds for objection and include the figure for the revised assessment.

Where the tax authority is satisfied with the ground of objection, or agree with the taxpayer on alternative figure, the assessment will be discharged and revised/ amended assessment would be raised.

However, where the tax authority did not agree with the taxpayer on the ground of objection, the tax authority will issue a Notice Of Refusal to Amend (NORA).

If after raising objection to a disputed assessment by the taxpayer and the relevant tax authority issue a Notice Of Refusal to Amend the assessment, an appeal will be lodged by the taxpayer with the Tax Appeal Tribunal (TAT). Should the Tax Appeal Tribunal refused the appeal on points of law, an appeal will be made against such decision to the Federal High Court. Further appeal by the Federal High Court will be made to the court of Appeal and Supreme Court.

(c). A notice of appeal to Tax Appeal Tribunal (TAT) shall contain the following:

i. The name and address of the taxpayer;
ii. The official number of the assessment and the year of assessment for which it was made;
iii. The amount of the tax charged by such assessment;
iv. The amount of the total profits upon which the tax was charged as appearing on the notice of assessment;
v. The date on which the appellant was served with the notice of refusal by the Board to amend the assessment as desired;
vi. The precise grounds of appeal against the assessment, such grounds shall be limited to the grounds stated by the appellant in its notice of objection; and
v. Address for serve of any notice, or other documents to be given, to the appellant, by the Tax Appeal Tribunal.

Examiner's Report

The question tests candidates' understanding of assessment procedure after tax audit, objection and appeal procedure for a disputed liability and contents of appeal to the Tax Appeal Tribunal. About 90% of the candidates attempted the question but performance was just average.

The commonest pitfall was that candidates were confusing assessment procedure after tax audit with objection and appeal procedure for a disputed tax audit assessment.

Candidates are advised that they should ensure adequate preparation for future examination.

6. Tax investigation is not carried out on a routine basis like tax audit. In most cases, tax investigation would be carried out when a taxpayer is suspected to have committed tax fraud.

Required:

(a) Identify Eight (8) situations that could trigger tax investigation of the taxpayer by the tax authority. (8 Marks)

(b) Explain the power of search and seizure under investigation by the tax authority. (4 Marks)

(c) State Three (3) conditions that could lead to termination of tax investigation. (3 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 6

(a) Tax investigation could be triggered by the following situations:

i. Failure to register for tax purposes;
ii. Refusal to file tax returns despite persistence request and visitation by the tax office;
iii. Refusal to allow access to books and records;
iv. Abusive tax scheme or aggressive tax avoidance scheme;
v. Suspicion of tax fraud;
vi. Denial of access of tax audit exercise;
vii. Regulatory authority sanction of the taxpayers i.e CBN, NDIC, SEC, NCC etc.
viii. Non –remittance of tax collected on behalf of tax authority i.e withholding tax;
ix. Negative media tax report on the taxpayer;
x. Whistle blowers on tax evasion/fraud by the taxpayer; and
xi. Referral from tax audit or tax law enforcement agencies.

(b) To conduct tax investigation by tax authority, the power of search and seizure could be exercised. Where the tax authority has a reasonable ground to suspect that an offence involving total or partial non-disclosure of information or any irregularity or offence in connection with tax has been committed or can be found on the premises, registered office or any office or place of management of the taxpayer or the residence of its principal officers, agents or representatives, the tax authority may authorise any of its officers to enter if necessary by force such locations at any time from the date of such authorisation and conduct a search.

The authority to enter and search must be made on the prescribed form in the sixth schedule of the Company Income Tax Act (CITA) and eight schedule of Personnel Income Tax Act (PITA).

Upon entry the premises, the officer may seize and remove anything whatsoever found therein which he has reasonable cause to believe may be required for the purpose of arriving at a tax and correct tax chargeable on the taxpayer or as evidence for the purpose of proceeding in respect of such offence.
Any officer authorised to carry out any such search and seizure may execute any warrant by calling to his assistance any police officer and it shall be the duty of the police officer to aid and assist him.

(c) Tax investigation could be terminated under any of the following conditions:

i. Insufficient evidence;
ii. Criminality is not involved i.e if established that what happen was tax avoidance and not tax evasion or tax fraud;
iii. Termination is required by law, where continuation can no longer be sustained under the provision of the law; and
iv. If the suspected taxpayer dies or become medically or legally insane

Examiners report.
The question tests candidates' understanding of tax investigation. Many of the candidates attempted the question and performance was good.

Candidates are advised to familiarise themselves with provisions relevant tax laws when preparing for future examination.

7. The Federal Inland Revenue Service (FIRS) has constituted a tax audit team to visit a company named Aboniki Limited with Mr. Okiki as the Team Leader. During the visit, the Team will also tour the premises of the company.

Required:

(a) Identify Five (5) pre-audit preparations that Mr. Okiki should focus on. (5 Marks)

(b) State Five (5) objectives of a pre-audit meeting. (5 Marks)

(c) Enumerate the Five (5) benefits of touring the taxpayer's premises. (5 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) The following pre –tax audit preparations are the areas Mr. Okiki should focus on as the audit Team leader:

i. The tax files of Aboniki Limited should be obtained for preliminary review to ensure that the audit team acquaint themselves with background information about the company;
ii. Based on the review of Aboniki Limited tax file, tax audit checklist and audit programme should be drawn;
iii. A formal letter of tax audit notification should be sent to Aboniki Limited;
iv. He should follow up the formal letter of tax audit notification with a call to Aboniki Limited to mutually agree the tax audit commencement date;
v. The schedule or list of information required for the Audit should be sent to Aboniki Limited;
vi. The tax audit team member should be constituted based on the level of their experience and technicality or complexity of tax audit of Aboniki Limited, considering the background information; and
vii. Tax risk profiling of Aboniki Limited should be conducted.

(b) The objectives of Pre-Audit Meeting include:

i. Informing the taxpayer the purpose of the audit;
ii. Confirming background information of the taxpayer earlier obtained in the permanent file;
iii. Getting other relevant facts that are not available in the file;
iv. Familiarising with the company's accounting and operational systems in order to ascertain:
    - ✓ Whether the accounting system is manual or computerised;
    - ✓ The invoicing system that is in place for sales and purchases; and
    - ✓ All cash received are banked intact before expending from it.
v. Giving the taxpayer opportunity to express his/her views on the audit; and
vi. Seeking the cooperation of the taxpayer in terms of providing books, record, documents and explanation where necessary etc.

(c) The benefits of touring the premises of the taxpayer include:

i. Appreciate and confirm the size and scale of taxpayers operation;
ii. Understand the way the taxpayers conduct their businesses, and the manner in which the taxpayers process their work;
iii. Show the taxpayer that the tax auditors are interested in conducting a professional audit;
iv. Enable the tax auditors to confirm and clarify information received during interview; and
v. Assist the tax auditor in risk assessment of the tax file.

Examiner's Report:

The question tests candidates' understanding of pre-tax audit preparations, pre-audit meeting and benefits of touring the taxpayers premises during tax audit. Most candidates attempted the question and performance was very good.

Candidates are encouraged to always cover all areas of the syllabus when preparing for future examination.

PTE II: FINANCIAL TAX ANALYSIS

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

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

1. Dat Holdings Nigeria Limited has two subsidiaries, Adeco Nigeria Limited and Hadot Nigeria Limited, each operating in the same industry and producing the same products but in different geographical locations.

   The following are the information provided by the two companies on their activities, for the year ended 31 December, 2021:

	Adeco ₦m	**Hadot** ₦m
Revenue	8,000	4,950
Cost of Sales:		
Variable Production Costs	(2,000)	(2,000)
Fixed Production Costs (including depreciation see Note c)	(4,000)	(1,950)
	(6,000)	(3,950)
Gross Profit	2,000	1,000
Administration Costs (Fixed)	(600)	(400)
Operating Profit	1,400	600
Non-Current Assets:		
Cost	10,000	9,000
Depreciation (See notes below)	(2,000)	(6,150)
	8,000	2,850
Net Current Assets	1,000	750
Capital Employed	9,000	3,600

Discussions with the management of the two companies reveal the following:

(a) The non-current assets of both companies are all used in their manufacturing processes;

(b) The two companies use different depreciation policies: Adeco depreciates its non-current assets using straight-line depreciation at the rate of 20% of cost with no residual value; whereas Hadot uses the reducing balance method of depreciation at the rate of 25% per annum;

(c) Included in the fixed costs of the year ended 31 December, 2020 is depreciation of ₦2,000 million for Adeco and ₦950 million for Hadot; and

(d) Each company purchased all its non-current assets in the month the company was formed. None of the companies has purchased or disposed of any non-current assets since their original purchase.

You have been informed that the board of Dat Holdings has decided to evaluate and compare the performance of both subsidiaries. The Managing Director of Hadot has been asked to explain the company's results compared to those of Adeco. The Managing Director says the differences are because of Adeco's depreciation policy and the age of the company's assets.

Required:

(a) Calculate the following ratios for the two subsidiaries:
  (i) Return on capital employed (ROCE);
  (ii) Operating profit margin; and
  (iii) Assets turnover. (6 Marks)

(b) For an objective comparison of the performance of both subsidiaries, carry out the necessary accounting adjustments to their financial statements. (8 Marks)

(c) Re-calculate the ratios, where necessary, as required in (a) above. (4 Marks)

(d) Discuss reasons why there are changes in the ratios you calculated and those that were previously calculated. (6 Marks)

(e) Appraise the performance of the two companies, based on the ratios you have calculated. (6 Marks)

(f) Discuss why accounting adjustments is sometimes necessary for a financial analyst before any meaningful financial statement analysis. (10 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

Dat Holding Nigeria Limited

(a).

	Adeco	HAdot
ROCE	1,400/9,000% = 15.56%	600/3,600% = 16.67%
Operating profit margin	1,400/8,000% = 17.50%	600/4,950% = 12.12%
Assets turnover	8,000/9,000 = 0.89	4,9500/3,600 = 1.38

(b). Analysis of Hadot's non –current assets shows that they are four years old:

	₦ m	
Cost	9,000	
Depreciation@ 25% in year 1	2,250	
	6,750	
Depreciation @ 25% in year 2	1,688	
	5,062	
Depreciation @ 25% in year 3	1,266	
	3,796	
Depreciation @ 25% in year 4	949	
	2,847	as shown in the question, approximately.

If the non- current assets of Adeco are depreciated at the rate of 25% on a reducing balance basis (i.e the same method as used by Hadot) and its assets aged forward to year 4 then its depreciation charge for the year will be ₦1,055 (see below) thus increasing its profits to ₦2.345b; and its non – current asset value will reduce by ₦4.836b so that its capital employed is ₦4.164b.

Adeco depreciation:

	₦
Original cost	10,000
Depreciation@ 25% in year 1	2,500
	7,500
Depreciation@ 25% in year 2	1,875
	5,625
Depreciation@ 25% in year 3	1,406
	4,219
Depreciation@ 25% in year 4	1,055
	3,164

(c)
After carrying out the adjustments to Adeco's non-current assets, the three ratios are recalculated as follows:

i.	ROCE	2,345/4,164	=	56.32%
ii.	Operating profit margin	2,345/8,000	=	29.31%
iii.	Assets Turnover	8,000/4,164	=	1.92%

(d). There are changes in the ratios of Adeco Limited because Adeco Limited adopted a straightline depreciation method, 20% per annum, which increased its annual depreciation charge. While Hadot Limited used a reducing balance method, 25% per annum, which resulted in a lower depreciation charge in year 4. Unlike Adeco which maintained the same amount of depreciation yearly, which resulted in a higher depreciation charge. This effectively reduced Adeco's operating profit margin, which resulted in poor ratios. However, when an adjustment is made, by adopting the same policy with Hadot, it resulted in lower depreciation charge and a higher operating margin. This resulted in improved ratios for Adeco Limited.

(e)

From Adeco's new ratios, Adeco's performance is better than that of Hadot. ROCE of Adeco's is 56.3%, compared to 16.7% of Hadot. Also, Adeco's operating profit margin is now 29.3%, as against 12.1% of Hadot. In the same vein, asset turnover of Adeco is now 1.9, compared to 1.4 of Hadot.

(f). Once the financial analyst has considered the accounting distorting present in the entity's financial statements, the analyst will evaluate whether accounting adjustments are needed to correct the distortions in the financial statements.

Adjustments may be because:

i. The accounting policies of the entity do not reflect the underlying economic situation of the entity;
ii. The management deliberately decided to distort the entity's performance; and or

   The management intends to make the financial statements comparable over time;
iii. Accounting standards may not reflect economic reality of the entity;
iv. The need to remove management bias that have been introduced in the preparation of financial statement; and
v. The need to make the financial statements comparable across the years or across entities.

Therefore, adjustment to financial statements are made for the following reasons:

- Accounting standards may not reflect economic reality of the entity;
- To remove management bias that have been introduced in the preparation of financial statements; and
- To make the financial statements comparable across the yeas or across entities.

Examiner's Report

Question one is a compulsory question and almost all candidates attempted the question. The question tests the candidates' knowledge on adjustment of depreciation figure to bring two companies to the same bases for the purpose of making comparism and computation of ratios. Performance in (a) part was fair as many of the candidates were able to calculate the ratios from figures already stated in the question. However, performance in (b), (c) and (d) was poor as majority of the candidates were not able to carry out adjustment of depreciation necessary to recompute the ratios. Part (f) of the question is a straight forward question on why accounting adjustment is necessary, but performance in this part also was not good enough.

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

2. Bari Ltd is an enterprise that deal in Electrical appliances. You are the Tax Consultant of the Company. Bari Ltd acquired Plant and equipment costing ₦10,000,000 on January 1, 2017. The asset is depreciated on a straight line basis at 20% on cost per annum. The capital allowances granted on this asset over the five years are as follows:

Yr. 2017 5,000,000
Yr. 2018 1,000,000
Yr. 2019 1,000,000
Yr. 2020 1,000,000
Yr. 2021 1,000,000

The company approached you as the Tax Consultant that in order to carry out an effective and reliable tax analysis, they require your computation in the following areas:

(a) Difference between Capital Allowance and Depreciation. (4 Marks)

(b) Temporary Difference and Deferred Tax Liability. (6 Marks)

(c) Opening and closing balance of deferred tax liability (5 Marks)

Companies Income Tax Rate is 30%

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a). Differences between capital allowance and depreciation

S/N	**Year**	**Capital Allowance**	**Depreciation**	**Differences**
		₦	₦	₦
1	2017	5,000,000	2,000,000	3,000,000
2	2018	1,250,000	2,000,000	750,000
3	2019	1,250,000	2,000,000	750,000
4	2020	1,250,000	2,000,000	750,000
5	2012	1,250,000	2,000,000	750,000

(b). Temporary differences and deferred Tax liability

S/N	Year	Carrying Value (Cost less Accumulated Depreciation) N	Tax Base (Cost less Accumulated Capital Allowance) N	Temporary Differences x Tax rate N	Deferred Tax Liability N	Increase / Decrease
1	2017	8,000,000	5,000,000	3,000,000 x 30%	900,000	-

2	2018	6.000,000	3,750,000	2,250,000 x 30%	675,000	(225,000)
3	2019	4,000,000	2,500,000	1,500,000 x 30%	450,000	(225,000)
4	2020	2,000,000	1,250,000	750,000 x 30%	225,000	(225,000)
5	2021	Nil	Nil	Nil	Nil	Nil

(6 marks)

(c). Opening and closing balance of deferred tax liability

	Yr 1 (2017) N	Yr 2 (2018) N	Yr 3 (2019) N	Yr 4 (2020) N	Yr 5 (2021) N
Opening Deferred Tax Liability	Nil	900,000	675,000	450,000	225,000
Increases / decrease (Profit / Loss)	900,000	(225,000)	(225,000)	(225,000)	(225,000)
Closing Deferred Tax Liability (Statement of Financial Position)	900,000	675,000	(450,000)	225,000	Nil

Examiner's Report
Question two test candidates' knowledge on capital allowance and calculation of timing difference and deferred tax liability. Majority of the candidates attempted this question and the performance was fair. However, some candidates were not able to compute the temporary difference and deferred tax correctly.

This is a common topic in Financial /Tax Analysis and candidates would have performed very well if they have read their study pack. Candidates are advised to make adequate preparation for the examination in the future.

3. You have just been employed as a financial analyst by Exim Bank Limited. Your responsibilities include analysing the financial statements of your bank's prospective customers. However, before you start analysing any financial statement, you are to ensure that the information presented in the financial statements are reasonable. You are required to make necessary adjustment, when necessary.

Required:
Discuss areas of distortions in the components of financial statements that the financial analyst needs to adjust before carrying out any meaningful financial statements analysis. (15 Marks)

SOLUTION TO QUESTION 3

Some distortions that call for adjustments include:
- Assets distortions;
- Liabilities' distortions; and
- Equity distortions.

(a). Assets distortion can arise due to the following situation:

Provision: There are various provisions that are required to be made in connection with the various assets in the financial statements, for example:

- Provision for depreciation on PPE;
- Provision for inventories, due to loss in value as a result of obsolescence, slow moving items, etc.;
- Provisions for prepaid expenses and revenue not yet earned; and
- Bad debt allowance on receivables.

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

Asset impairment: Recognising too much or too little asset impairment of PPE, investments and intangibles can cause distortions in the asset value. This is because estimation of fair value is subjective and can be a veritable ground for management bias and management can therefore, delay reporting impairment in the financial statements.

Expenses capitalisation: As a form of earnings management, expenses could be capitalised or deferred too much or too little. Management, under IAS 38, has discretion in deciding whether to capitalise or expense interest and expenditure required to get PPE and inventory to current location and condition. Deferred expenditure is capitalised into the cost of the asset and this will impact on income. However, if the management decides that the potential future benefits cannot be reliably measured, the standard allowed the management to expense the expenditure.

Leased assets: If the entity uses substantial leased assets and these are not brought into the financial statements, it will lead to reduction in the value of the entity's assets which will result in distortion. However, this distortion has been effectively removed by provisions of IFRS 16 – Leases, which requires all leases to be capitalised as right if use assets.

(b). **Liability distortions**

Distortions in liabilities generally arise because there is ambiguity about whether an obligation has really been incurred or the obligation can be measured. The most common forms of liability understatements arise when the following conditions exist:

- Unearned revenues are understated through aggressive revenue recognition;
- Provisions are understated;
- Discounted receivables are off- balance sheet; and
- Post –employment obligations, such as pension obligations, are not fully recorded.

(c). **Equity distortion**

Pre- 2016, unrealised gains and losses on assets held for sale (vs for short – term trading) were reported in the Statement of comprehensive income and therefor affect equity without impacting earnings until realised (recycling gains). Available – for sale securities are reported as fair value; changes in value between accounting periods are included in comprehensive income until the securities are sold. –IFRS 9 now requires recognition through income statement but for prior years, analysts may restate to remove the distortion of return on equity.

Examiner's Report

The question test candidates' knowledge on the identification of area of distortions in the financial statements that will require adjustment. This is a straight forward question but only few candidates appear to have good understanding of the requirement of the question. About 50% of the candidates attempted this question, and performance was poor.

The commonest pitfall was the inability of the candidates to accurately discuss the distortion in the components of the financial statement.

Candidates are advised to study very well for the examination by reading the Study Pack provided by the Institute and the pathfinder to ensure good performance in future examination of the Institute.

4. The Federal Government introduced some measures to promote industrialisation by collaborating with local and foreign investors.

You are required to:

State the tax incentives for investors under the following headings:

(a) Small Manufacturing Companies (6 Marks)

(b) Solid Minerals (3 Marks)

(c) Hoteliers and Tourism (3 Marks)

(d) Research and Development (3 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

Tax Incentives for Inventors

(a). Small Manufacturing Companies: Small manufacturing companies are those with less than ₦100million Turnover.

i. They are to pay Income Tax at 20% for the first four years of commencing business.

ii. Dividends from small manufacturing companies are exempted from tax for the first four years of business operations.

iii. No tax is payable on interest charged by banks for manufacturers of export goods

iv. Dividend derived from manufacturing companies in the Petrochemical and Liquefied Natural Gas sub – sectors are tax exempt.

v. There are no restrictions on Capital Allowances claimable by small Manufacturing Companies.

(b). Solid Minerals

i. Companies engaged in the mining of solid minerals are entitled to claim Initial and Annual Allowances as follow: Initial Allowance 95% Annual Allowance Nil

ii. In addition, they are to enjoy tax-free holiday for the first three years of operation.

iii. Low rate of tax, 20% is payable by small companies in the mining of solid minerals for the first four years from commencement.

(c). Hoteliers and Tourism: Twenty-five percent (25%) of income derived from tourism by hotels in convertible currencies will be exempted from tax with effect from 1996, provided such incomes are set aside and put in a reserve fund to be utilised within five years in expansion or the construction of new Hotels. The amount to be allowed as deductible shall not exceed 15% of total profit or 25% of taxable profit, whichever is higher.

(d). Research and Development

i. Companies and other organisations that engage in Research and Development activities for commercialisation are to enjoy 20% Investment Tax credit (ITC) on their qualifying capital expenditure.

ii. Donations to Universities and Research Institutions are tax deductible

iii. Reserve made out of the profits of a period, which shall not exceed an amount equal to 10% of total profits that company as ascertained before any deduction is made.

Examiner's Report

The question tests the candidates' knowledge on tax incentives in four areas. Small manufacturing companies. Solid mineral, Hoteliers and Tourism, Research and Development. The question is straight forward and majority of the candidates attempted the question.

The performance was poor as many of the candidates that attempted the question scored below average mark.

The commonest pitfall was the inability of majority of the candidates to state tax incentives in specific sector required by the question.

Candidates are advised that they should ensure they cover the entire syllabus when preparing for future examination.

5. Effective corporate management requires taking full account of tax implications in the decision–making process. Tax strategy is a part of the firm's financial strategy which in turns forms part of the firm's overall corporate strategy. It is usual therefore, that when a company is planning its business strategy, consideration is given to tax strategy.

Required:

(a) Discuss Corporate Strategic planning (7 Marks)

(b) List Eight (8) items under Corporate tax strategy. (8 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 5

Corporate Strategic Planning and Corporate Tax Strategy

(a) **Corporate strategic planning** is defined as a systematic process of determining goals to be achieved in the foreseeable future. It consists of:

- Management's fundamental assumptions about the future political, economic, socio-cultural, technology, legal and competitive environments;

  An internal and external appraisal of the firm's situation which comprises of its strengths and weakness, opportunities and threats in the environment, that is, SWOT analysis;

- Setting of objectives and goals to be achieved within a specific time frame;
- Selection of main and alternative strategies that will help management to achieve set objectives and goal; and
- Formation, implantation of tactical and operational plan to achieve interim objectives and monitoring and evaluation of performance from time to time.

This corporate planning process includes planning the corporate's financial strategies which includes:

- Financing decision;
- Investment decisions; and
- Dividend decisions

All the above financial management decisions have tax implication. Therefore, in arriving at corporate financial strategies in its corporate strategic planning process, a firm must consider adequately its tax strategy which is aimed at reducing the overall corporate tax liability and at the same time maximise the shareholders' wealth. This is where strategic tax planning comes into play.

(b). Corporate Tax Strategy includes:

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

Examiner's Report
The question tests the candidates' knowledge on concept of strategic planning and corporate tax strategy. This is a straight forward question and the topic is dealt with extensively in the Institute study pack for the subject.

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

The commonest pitfall was inability of the candidates to discuss component of corporate planning and state corporate tax strategy.

It must be stated again that candidates need to study very hard for the Institute's examination by reading the relevant study materials.

6. (a) Explain industry segmentation and industry trend. (6 Marks)

(b) Discuss Base erosion and Profit Shitting (BEPS) strategy being used in international tax planning and the reason why multinational companies are able to use this strategy. (9 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 6

(a). **Industry segmentation and Industry Trend**

Industry segmentation
This is the process of defining and subdividing a large homogenous market into clearly identifiable components having similar need, wants, or demand characteristics. Industry segmentation is determined by factors such as products, target markets, geography, demographics and size of businesses that constitute an industry. Industry segmentation determines key factor such as product, pricing, business composition and resources required for operation. A manager needs to understand industry segmentation as it has an influence on technology resources and technology enablement within the industry.

Industry Trend
This is an assumed tendency of a given industry to move in a particular direction over time. Primary trends for maximum time frames, and secondary trends lasting for many years has been a primary cause and rapid disruptive force for managers in the last fifty years for making the role of managers very important in signaling industry changes arising from technology trends to provides input and direction for technology strategy.

(b). **(i) Base Erosion and profit Shitting (BEPS)**
The commonly used international tax planning strategy is base erosion and profit shifting (BEPS) strategy. BEPS refers to corporate tax planning strategies used by multinational enterprises to shift profit from higher tax jurisdictions to lower tax jurisdictions thus eroding the tax base of the higher tax jurisdiction. This is done by exploiting the gaps and mismatches in the tax rules. However, it has been observed that intellectual property is used as tools for this strategy.

Base erosion is a tax planning strategy whereby the size of a company's taxable profit is reduced in a country with higher tax rate. This is achieved by writing off certain expenses against the profit so as reduce the taxable profit.

Profiting shifting is a tax planning strategy which is used by a group of companies or a multinational enterprise whereby profit is moved from jurisdiction with high tax rate to jurisdiction with low tax rate. The essence is to reduce the overall after-tax profit that is available to the group shareholders. This strategy uses intra-group payments, such as, royalties, interest, etc., which are tax deductible.

Together, base erosion and profit shifting (BEPS) are employed by multinational enterprises to shift profits from jurisdiction with higher tax rate to jurisdiction with lower tax rate, in order words, taxable profit or tax base is eroded from jurisdiction with higher tax rate.

(ii). **Reasons why Multinational enterprises are able use this strategy**

- Their international operations, with companies in different jurisdictions provide such opportunity;
- Their large volume of capital enables them to set up companies in various jurisdictions which can be used for that purpose; and
- They have large incomes and are able to take advantage of the services of international tax consultants that provide appropriate advice on tax regimes in various jurisdictions.

Examiner's Report

The question in two parts, tests industry segmentation and trend, and base erosion and profit shifting strategies by multinational companies. This is a direct question that candidates are expected to perform well, however, performance was just fair. Majority of the candidates explained segmentation as departmentalisation.

Candidates are advised to read and understand questions very well before attending them. They should read the study pack and Pathfinder very well to ensure good performance in future examination of the Institute.

7. Discuss the steps involved in order to carry out accounting analysis to minimise the issue of aggressive or big bath accounting. (15 Marks)

SOLUTION TO QUESTION 7

Step in performing accounting analysis

In order to carry out accounting analysis to minimise the issue of aggressive or big bath accounting, the following steps should be taken:

(i). Identify key (principal) accounting policies: Accounting policies have effect on figures presented in the financial statements. The way each organisation treats issue like material, depreciation, capitalisation of some expense contributes to variation in profit to be reported in the financial statements. In carrying out accounting analysis, some of these issues would be looked into to ensure that the accounting policies are still within the normal acceptable for financial reporting;

(ii). Identify and evaluate the policies and estimates the firm uses to measure critical business factors and key risks. It is very pertinent in carrying out accounting analysis to identify and evaluate the policies as well as estimates an organisation is using to measure critical business factors and risk. Such evaluation will inform the analysis on how these policies affect the organisation;

(iii). Financial reporting provides that the organisation can be flexible in the preparation of their financial statements as long as it is within the normal accounting practices. In performing accounting analysis, this accounting flexibility must be assessed. Understanding flexibility and resulting information contents are very necessary – if managers have little flexibility in choosing accounting policies and estimates related to their key success factors, accounting data are likely to be less informative for understanding the firm's economics;

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

(v). it is necessary to evaluate how the firms accounting policies compare to that of the industry in which the organisation operates. In some industry they practice uniform costing and accounting system. In performing accounting analysis, how much a firm has conformed with the industry practice should be assessed;

(vi). The quality of disclosure must be evaluated as well as determine that all necessary disclosures are made in the financial statements; and

(vii). Identification of potential red flags (accounting distortions) should be carried out, this distortion should be corrected when performing accounting analysis.

Examiner's Report

The question test candidates' knowledge on steps involve in accounting analysis in order to minimise the issues of aggressive or big bath accounting. The question is a straight forward and understood by majority of the candidates.

Majority of the candidates attempted the question. Performance was above average. The commonest pitfall was that some candidates discussed accounting information parameters instead of accounting analysis.

Candidates are advised to study very well for the examination and ensure good understanding for the requirement of the question before attempting them

PTE II: INTERNATIONAL TAXATION

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

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

1. (a) Mention Five (5) objectives of the Income Tax (Transfer Pricing) Regulations 2018 issued by the Federal Inland Revenue Service (FIRS) in March 2018.
(5 Marks)

(b) Tech-Giant Limited, a company incorporated in Nigeria is a part of the manufacturing group, Tech-Giant Group of Companies, a leading manufacturer and distributor of seismic machineries. Tech-Giant Limited imports machinery manufactured by two other companies within their group; Tech-Giant Japan and Tech-Giant India. The machines are purchased and imported by Tech-Giant Limited from Tech-Giant Netherlands, the group's centralised inventory company.

Other additional information are as follows:

(i) Tech-Giant Limited ("TGL") commenced business in 2016. Previously, an unrelated company, Symbal Digital Limited, had carried out the distribution of Tech-Giant machineries in Nigeria. You have been able to obtain a copy of the last set of accounts of Symbal Digital Limited for the year ended 31 December, 2016 and they show a gross margin/sales of 45%;

(ii) Tech-Giant Limited is not an overly active company. It has seven (7) employees, who operate from a large warehouse just at the outskirt of Lagos, along the Lagos-Abeokuta expressway. It maintains a stock of spare parts and a few machines for display purposes. Generally, Tech-Giant Limited imports machines as and when they are ordered by the clients and then arranged for delivery using a contracted transport company. There is no value added to the machines in Nigeria; and

(iii) Of the seven (7) staff, two (2) are Sales Representatives, two (2) are Technical Assistants, one (1) is Financial Accountant, one (1) is Executive Assistant to CEO and there is the CEO. The Technical Assistants provide technical support for the Tech-Giant machinery including reviews of sales proposals from Tech-Giant Limited to its clients.

Tech-Giant Limited
Profit or Loss Account Summary for 2016 to 2020

	2016	2017	2018	2019	2020
	₦	₦	₦	₦	₦
Turnover	1,250,000	2,324,000	3,200,000	4,159,000	4,359,000
Cost of sales	811,000	1,446,000	2,051,000	2,587,000	2,711,000
Gross profit (GP)	439,000	878,000	1,149,000	1,572,000	1,648,000
GP to turnover	35%	38%	36%	38%	38%
Operating Expenses	508,000	911,000	1,421,000	1,855,000	1,933,000
Profit/(Loss) before tax	(69,000)	(33,000)	(272,000)	(283,000)	(285,000)
Profit margin	(5.52%)	(1.42%)	(8.5%)	(6.8%)	(6.54%)
Purchases from Group Companies	770,000	1,374,000	1,948,000	2,458,000	2,575,000
Management fees to Tech-Giant Ukraine	0	0	160,000	208,000	218,000

Based on the information provided, you are required to perform an assessment of Tech-Giant Limited for possible Transfer Pricing Risk and address the following:

(a) Identify which of the circumstances of the company that are of particular concern to you and give reasons for your answer. (25 Marks)

(b) Is there any cause of further investigation? If so, what additional information do you think will help your investigation? (10 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) The objectives of the 2018 Transfer Regulations include:

(i) To ensure that Nigeria is able to tax on appropriate taxable basis corresponding to the economic activities deployed by taxable persons in Nigeria, most especially in their transactions and dealings with associated enterprises;

(ii) To provide the tax authorities in Nigeria with the right tools to fight tax evasion usually camouflaged and perpetuated through the instrumentation of under-pricing or overpricing of controlled transactions between associated enterprises;

(iii) To reduce the risk of economic double taxation;

(iv) To provide a level playing field for both multinational enterprises and independent enterprises doing business in Nigeria; and

(v) To provide taxable persons with certainty of transfer pricing treatment in Nigeria.

(b) (i) Tech-Giant Limited – Areas of particular concern may include:

- **Related party transactions**
  Purchases by Tech-Giant Limited from other companies in the group of companies accounted for 95% of its cost of goods sold. Intra-group transactions by companies within the same group may not have been made on terms, which might fairly have been expected to have been made by

independent persons engaged in the same or similar activities dealing with one another at arm's length.

- **Gross margin (gross profit as percentage of sales)**
  The gross margin made by Tech-Giant Limited over 2016-2020 was in the range of 35% to 38% which was significantly lower than 45% gross margin made by an unrelated company Symbal Digital Ltd, when it was the distributor of Tech-Giant machineries in Nigeria.

- **Losses before tax**
  The accounts of Tech-Giant Limited showed poor performance (loss situation) repeatedly. The company made losses each year since it commenced operation in 2016.

- **Management fees to Tech-Giant Ukraine**
  Effective from 2018 Tech-Giant Limited started to pay management fees to its parent company at 5% of turnover. This further contributed to loss position of the company.

- **Transfer pricing/artificial transactions**
  Many multinational companies are interested in maximizing their head office profits, hence, they may adopt transfer pricing mechanism which boost the head office profits at the detriment of the associated or subsidiary companies which operate in other tax jurisdictions. Therefore, it is possible that the machines supplied to Tech-Giant Limited by Tech-Giant Japan and Tech-Giant India through Tech-Giant Netherlands were overpriced. Consequently, the Nigerian subsidiary recorded low profits and paid less tax to the Nigerian Government, while the other group companies made more profits.

(ii) Need for further Investigation
In view of the repeated losses incurred by Tech-Giant Nigeria Ltd, lower gross margins and a higher volume of related party purchases, it is necessary to carry out further investigation into the company's transactions with emphasis on purchases from group companies. This will enable the FIRS to know whether such purchases were artificial or fictitious transactions designed to boost head office profits at the detriment of the subsidiary company in Nigeria.

To carry out further investigation, there is need for information on transactions between related companies particularly purchases from related companies by Tech-Giant Nigeria Ltd. There is also need for information on the prices/terms for similar transactions carried out by independent enterprises to see whether arm's length principle was observed in related party transactions. In other words, there is need for a reasonable number of local comparable, open market transactions on which to draw comparison and conclusions.

EXAMINER'S REPORT
The question examines the candidates' understanding of related part transactions and transfer pricing. The question is a compulsory question and was attempted by all the candidates. However, candidates performance was abysmally poor. This was due to candidates' lack of understanding of the question and the topic in general.

Candidates are advised that they should ensure complete courage of the syllabus when preparing for future examination.

2. (a) Explain the concept of international taxation. (4 Marks)

(b) List the Three (3) objectives of international tax rules. (3 Marks)

(c) The digital economy is increasingly becoming the economy itself as international border are closing in and distance is no longer a barrier to sealing business deals.

Required:
As a would be chartered tax practitioner:

(i) Mention Three (3) of the essential elements of the digital economy. (3 Marks)

(ii) State Five (5) of the advantages of digital economy. (5 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) Concept of International Taxation

International taxation is governed by the principles of tax equity and tax neutrality. Tax equity demands that tax accruing be shared equitably amongst nations and that no assessee is discriminated or given undue preference in their tax burdens. Tax neutrality refers to the relationship between the taxpayer and the state.

OR

International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries, or the international aspects of an individual country's tax laws as the case may be.

(b) Objectives to international tax rules

International tax has developed its own criteria and when a national government examines its international tax rules, it wants to achieve the following objectives:

(i) to get a reasonable share of tax from international business;
(ii) to maintain horizontal equity between its people; and
(iii) to encourage its own business or at least see that they are not unfairly discriminated against.

(c) (i) The essential of digital economy are:

* Digitalisation and intensive use of Information and Communication Technology (ICT);
* Codification of knowledge;
* Transformation of information into commodities;
* New ways of organising work and production;
* E-business;
* E-commerce;
* E-business infrastructure or infrastructure.

(ii) The advantages of digital economy include the following:

- Greater information through the internet;
- Transactions are concluded in short time – it saves time;
- It reduced costs as rent of expensive business premises/office and other overhead are avoided;
- Digital economy enables allows greater personal participation when compared with what is obtainable under the traditional economy;
- Digital economy comes with lower barriers to entry and exit;
- It create significant data which can lead to new insights;
- Digital economy is opening up opportunities for the developing world;
- It enables people to work from home;
- Increases production;
- Increases competitiveness;
- Increases employment opportunities;
- Improves living standards;
- Better quality of life;
- Reduces costs;
- Fasters transactions;
- Improves efficiency;
- Innovation;
- More personalisation;
- Greater convenience;
- Increases transparency; and
- Increases communication.

EXAMINER'S REPORT

The question examines the candidates' knowledge of the concept of international taxation and its objectives, the essential elements of digital economy and its advantages.

Most of the candidates attempted the question and performance was average.

The obvious pitfall was the inability of the candidates to properly explain the concept of International taxation and also to identify the essential elements of the digital economy.

Candidates are advised that they should ensure they make use of the Institutes' study pack when preparing for future examination.

3. (a) Mention the conditions for relief of double taxation in respect of income liable to tax under the laws of the commonwealth countries. (3 Marks)

(b) List Five (5) countries that has full double tax treaty with Nigeria. (5 Marks)

(c) Differentiate between Exemption and Credit Methods of double taxation relief under the Model Tax Convention for the avoidance of double taxation. (7 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) Conditions for granting relief under commonwealth tax

The relief in respect of income tax charged under the laws of commonwealth countries on income, which is also liable to Nigerian tax is granted based on the following conditions:

(i) Relief is only available to Nigerian residents i.e. individual and companies;
(ii) Relief is only given where the other country concerned has passed reciprocal legislation in respect of Nigeria income;
(iii) Relief is limited to half the applicable Nigerian tax rate; and
(iv) Claims for the CWTR for any year of assessment must be made not later than six years after the end of the year the tax was incurred.

(b) Countries that have entered into a full bilateral Double Tax Treaty with Nigeria include:

(i) United Kingdom and Republic of Ireland;
(ii) France;
(iii) Netherland (Holland);
(iv) Canada;
(v) Belgium;
(vi) Pakistan;
(vii) South Africa;
(viii) Romania;
(ix) Czech Republic;
(x) Philippines;
(xi) Slovakia;
(xii) Singapore;
(xiii) Spain; and
(xiv) Sweden.

(c) Methods of Double Taxation Relief

(i) Exemption Method

Under the exemption method, a State exempts from taxation certain items of income derived by its residents in another State. It may do so in accordance with its domestic legislation or by treaty. In essence, Exemption Method occurs where the country of residence exempts from tax the income, which has been taxed in the source country. Under this method, the country of residence is required to exempt from tax the income (brought into its jurisdiction), which may be taxed in the source country.

(ii) Credit Method

The essential feature of the credit method, whether granted unilaterally or by bilateral tax treaty, is that the Residence State treats a foreign income tax paid to the source State by its residents, within certain statutory limitations, as if it were an income tax paid to itself. Credit method occurs where the tax paid in the source country is allowed as a credit against the tax charged in the country of residence on the same income. Thus, where the income is taxable in both countries, the country of residence gives tax credit in respect of the tax already imposed and charged on the income or profit by the country of source.

The main difference between the two methods is the base for the relief from double taxation. Whilst exemption relates to foreign income of residents, credit on the other hand relates to the taxes paid by residents at source on their foreign income.

EXAMINER'S REPORT

The question tests the candidates' knowledge of the conditions for relief of double taxation on income under the laws of the commonwealth countries, the countries that has full double tax treaty with Nigeria and the difference between Exemption and Credit Methods of double taxation relief under the Model Tax Convention for the avoidance of double taxation.

Most of the candidates attempted the question and performance was above average.

The commonest pitfall of the candidates was their inability to clearly differentiate between Exemption and Credit Method of double taxation relief under the Model Tax Convention for the avoidance of double taxation.

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

4. (a) Explain the concept of residence and its importance to international taxation. (5 Marks)

(b) Define the following terms in relation to residence of an individual, based on the provisions of the First Schedule of the Personal Income Tax Act (as amended).

(i) Foreign Employment (2 Marks)

(ii) Principal place of residence (3 Marks)

(c) Explain the basis for the determination of residence in Nigeria of an individual who has a foreign employment. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) Concept of Residence

Under the residence principle, a State's claim to tax income is based on its relationship to the person deriving that income. For example, a State would invoke the residence principle to tax wages earned by a resident of that State without reference to the place where the wages were earned. In general, a State invokes the residence principle to impose tax on the worldwide income of its residents.

The concept of residence is garmane and fundamental to a greater degree in determining the extent to which a taxpayer's income or profit is liable to tax in a jurisdiction. A taxpayer resident in Nigeria for instance, is subject to tax in Nigeria on his/its global income or profits, whereas a non-resident taxpayer is subject to tax in Nigeria only on that part of his income derived from Nigeria. The importance of the residency concept also plays in the execution of double taxation treaties, as it often contains provisions on issues of residency and applicable rules for resolution in case of a dispute on jurisdiction to tax. This can be seen in the allocation of taxing rights between the countries to the tax treaty.

(b) Explanation of terms

(i) "Foreign employment" means an employment the duties of which are wholly performed outside Nigeria save during any temporary visit of the employee to Nigeria.

(ii) "Principal place of residence" in relation to an individual with two or more place or residence on a relevant day, not being both within any one territory means:

(a) In the case of an individual with no source of income other than a pension in Nigeria, that place of those places in which he usually resides;

(b) In the case of an individual who has a source of earned income other than a pension in Nigeria, that place of those places which on a relevant day is nearest to his usual place of work;

(c) In the case of an individual who has a source of unearned income in Nigeria, that place of those places in which he usually resides.

(c) Basis for the determination of residence in Nigeria, of an individual with foreign employment.

An individual not being a person to whom subsection (1)(b) of section 2 of this Act applies, who holds a foreign employment on the first day of January in a year of assessment, or who first becomes liable to income tax in Nigeria for that year by reason of his entering that employment during that year, shall be deemed to be resident for that year in the territory in which the principal office of his employer is situated on that day or on the day his foreign employment commences, as the case may be.

EXAMINER'S REPORT

The question tests the candidates' understanding of the concept of residence, it's importance to international taxation, meaning of foreign employment and principal place of residence, and the basis for determination of residence in Nigeria for individual with foreign employment.

Majority of the candidates attempted the question and performance was very poor.

The candidates' pitfalls were their misinterpretation of the question as well as their lack of understanding of the provisions of the First Schedule of the Personal Income Tax Act (as amended). Candidates are advised that they should ensure they familiarise themselves with all the relevant tax laws when preparing for future examination.

5. Discuss the criteria for breaking residency tie in the case of an individual with dual residence. (15 Marks)

SOLUTION TO QUESTION 5

Tie – breaker rule for dual residency of an individual

The criteria employed as tie-breaker in case of dual residency of an individual are as specified under Article 4(2) of the agreement for the avoidance of double taxation (i.e. Double Taxation Treaty/Agreement – DTT/DTA).

Tie-breaker in the event of a dual residency, presupposes that it is possible for a person to be deemed resident in two or more countries at the same time. The DTT/DTA (whether bi-lateral or multi-lateral) do often provide for a set of rules to be applied in resolving the problem of dual residency. These rules are referred to as the "tie breaker rule".

Where an individual has or claims dual residency of two countries who have entered into a Double taxation treaty:

(i) He shall be deemed to be resident in the State in which he has a permanent home available to him;
(ii) If he has a permanent home in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interest);
(iii) If his residence cannot be determined using the rules stated in (i) or (ii), he shall be deemed to be a resident of the State in which he has an habitual abode;
(iv) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
(v) If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

EXAMINER'S REPORT

The question tests the candidates' knowledge of the criteria for breaking residence tie in the case of an individual with dual residence.

Only few candidates attempted the question and performance was very poor.

The obvious pitfall was the lack of understanding of the question by the candidates. Candidates must ensure that they make use of the Institute study pack when preparing for future examination.

6. (a) The Value Added Tax Act does not discriminate between resident and non-resident taxable persons. Discuss this statement in line with the provisions of VAT Act in relation to taxable goods and services, giving Two (2) examples of each. (8 Marks)

(b) Mention the obligations of Non-Resident Companies under the Nigerian Value Added Tax Act. (7 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 6

(a) Application of VAT to both Resident and Non-Residents

The Value Added Tax Act does not discriminate between resident and non-resident taxable persons because, except for those goods and services which are specifically exempted from VAT as contained in the First Schedule to the Value Added Tax Act and VAT modification Orders 2020 and 2021, non-resident companies are expected to charge VAT on the supply of all other goods and services.

Examples of such goods and services are listed below;

(a) Vatable goods include:

(i) Computers;
(ii) Aircrafts and aircraft parts;
(iii) Jewellery;
(iv) Soaps and detergents;
(v) Furniture and equipments;
(vi) Carpets and rugs;
(vii) Cloths and clothing materials;
(viii) Beer, wine, liquor, etc; and
(ix) Cigarettes and tobacco.

(b) Vatable services include:
(i) Consultancy services;
(ii) Engineering services;
(iii) Management services;
(iv) Financial services;
(v) Technical services; and
(vi) Digital services.

(b) Obligations of Non-Resident companies under the Nigerian VAT Act

Both residents and non-residents are expected to discharge VAT obligations on registration, collection and remittances of VAT to the Federal Inland Revenue Service (FIRS), though the form for each category of taxpayers differs. Below are three (3) VAT obligations of non-resident companies:

(i) Registration for VAT: A non-resident company carrying on business in Nigeria is required by law to register with the FIRS for VAT using the address of the person or corporate entity with whom it has a subsisting contract, as its address for purposes of correspondence relating to tax. This situation has changed now as the non-resident companies can register directly online through the FIRS' tax administration portal;

(ii) Collection of VAT: For a non-resident, the obligation to collect VAT on their taxable activities is on the resident taxable person with whom the non-resident does business. The non-resident is obliged to invoice the VAT and the resident beneficiary of the taxable supply is obliged to withhold the VAT included in the invoice issued by the non-resident taxable person. The Act, therefore, makes the recipients of Vatable goods and services supplied by non-residents, the agent for collection and remittance of such collections to the FIRS. With the advent of the Finance Act, non-residents are now mandated to register for VAT directly through the FIRS online portal; and

(iii) Remittance of VAT to the FIRS: A non-resident taxable person has an obligation to include VAT in its invoice, the person to whom the goods or services are supplied in Nigeria has an obligation to withhold and remit VAT to the FIRS in the currency of the transaction. Thus, making the Nigerian recipients of Vatable goods and services supplied by non-residents, the agent for collection and remittance of such collections to the FIRS.

EXAMINER'S REPORT
The question examines the candidates' knowledge of the provisions of the VAT Act and the VAT modification orders 2020 and 2021 in relation to the obligations of non-resident companies and examples of vatable goods and services.

About 60% of the candidates attempted the question and the performance was abysmally poor.

The common pitfall was the candidates lack of understanding of the provisions of the VAT Act and the VAT Modification Order 2020 and 2021.

Candidates are advised that they should familiarise themselves with all applicable tax regulations when preparing for future examination.

7. (a) Regional economic integration and trade blocs is an integral and important development of international trade. It is fast growing and there are clamour for the fading ones to be resuscitated. A good example is the ECOWAS.

As an intending chartered tax practitioner, you are required to:

(i) Assess the advantages/benefits of regional economic integration and trade blocs. (4 Marks)

(ii) Enumerate the disadvantages, if any. (6 Marks)

(b) Double taxation agreement between Two (2) or more countries is essential to avoid confusion and make better understanding for trade and communication stability.

Required:
List the benefits of double taxation agreement. (5 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) Advantages of regional economic integration and trade blocs include the following:
(i) Trade creation: It provides more opportunities for countries to increase trade with one another;
(ii) Employment opportunity: By removing restrictions on labour movement, economic integration can help to expand job opportunities;
(iii) Consensus and cooperation: Member nations may find it easier to agree with smaller number of countries; and
(iv) Impetus for private sector planning and investment.

(b) Disadvantages of regional economic integration and trade blocs are:
(i) Trade diversion: Member nation may trade more with one another and avoid non member nation. Discriminatory tendencies may become prevalent;

(ii) Employment shift and reduction: Countries may move production to cheaper labour markets in member countries. Similarly, workers may move to countries with higher remuneration for labour; and
(iii) Possible loss of National Sovereignty: with each new round of discussions and agreement within a regional bloc, nations may find that they have to give up more of their political and economic rights.

(c) Some of the benefits of double taxation agreement are:
(i) Avoidance of double taxation;
(ii) Clarification of taxing rights of each contracting state;
(iii) Prevention to a great extent, the fiscal evasion with – avoidance provision;
(iv) Encouragement of economic cooperation between state; and
(v) Lowering compliance cost.

EXAMINER'S REPORT
The question tests the candidates' knowledge of the advantages and disadvantages of regional economic integration and trade blocks, and the benefits of double taxation agreement.
Many candidates attempted the question and performance was below average.

The commonest pitfall of the candidates was their lack of understanding of the question. Candidates could not provide specific answer to question asked.

Candidates are advised that they should prepare adequately for future examination by making use of the Institute's study pack and pathfinders.